

and 1171–1177] or title XVIII [§§ 1800–1899A] of Pub. L. 99–514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99–514, as amended, set out as a note under section 401 of this title.

TREATMENT OF CERTAIN LOSSES ON STRADDLES ENTERED INTO BEFORE EFFECTIVE DATE OF ECONOMIC RECOVERY TAX ACT OF 1981

Section 108 of Pub. L. 98–369, as amended by Pub. L. 99–514, § 2, title XVIII, § 1808(d), Oct. 22, 1986, 100 Stat. 2095, 2817, provided that:

“(a) **GENERAL RULE.**—For purposes of the Internal Revenue Code of 1986 [formerly I.R.C. 1954], in the case of any disposition of 1 or more positions—

“(1) which were entered into before 1982 and form part of a straddle, and

“(2) to which the amendments made by title V of the Economic Recovery Tax Act of 1981 [Pub. L. 97–34, see Effective Date note above] do not apply.

any loss from such disposition shall be allowed for the taxable year of the disposition if such loss is incurred in a trade or business, or if such loss is incurred in a transaction entered into for profit though not connected with a trade or business.

“(b) **LOSS INCURRED IN A TRADE OR BUSINESS.**—For purposes of subsection (a), any loss incurred by a commodities dealer in the trading of commodities shall be treated as a loss incurred in a trade or business.

“(c) **NET LOSS ALLOWED.**—If any loss with respect to a position described in paragraphs (1) and (2) of subsection (a) is not allowable as a deduction (after applying subsections (a) and (b)), such loss shall be allowed in determining the gain or loss from dispositions of other positions in the straddle to the extent required to accurately reflect the taxpayer’s net gain or loss from all positions in such straddle.

“(d) **OTHER RULES.**—Except as otherwise provided in subsections (a) and (c) and in sections 1233 and 1234 of such Code, the determination of whether there is recognized gain or loss with respect to a position, and the amount and timing of such gain or loss, and the treatment of such gain or loss as long-term or short-term shall be made without regard to whether such position constitutes part of a straddle.

“(e) **STRADDLE.**—For purposes of this section, the term ‘straddle’ has the meaning given to such term by section 1092(c) of the Internal Revenue Code of 1986 as in effect on the day after the date of the enactment of the Economic Recovery Tax Act of 1981 [Aug. 13, 1981], and shall include a straddle all the positions of which are regulated futures contracts.

“(f) **COMMODITIES DEALER.**—For purposes of this section, the term ‘commodities dealer’ means any taxpayer who—

“(1) at any time before January 1, 1982, was an individual described in section 1402(i)(2)(B) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as added by this subtitle), or

“(2) was a member of the family (within the meaning of section 704(e)(3) of such Code) of an individual described in paragraph (1) to the extent such member engaged in commodities trading through an organization the members of which consisted solely of—

“(A) 1 or more individuals described in paragraph (1), and

“(B) 1 or more members of the families (as so defined) of such individuals.

“(g) **REGULATED FUTURES CONTRACTS.**—For purposes of this section, the term ‘regulated futures contracts’ has the meaning given to such term by section 1256(b) of the Internal Revenue Code of 1986 (as in effect before the date of enactment of this Act [July 18, 1984]).

“(h) **SYNDICATES.**—For purposes of this section, any loss incurred by a person (other than a commodities dealer) with respect to an interest in a syndicate (within the meaning of section 1256(e)(3)(B) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954]) shall not be considered to be a loss incurred in a trade or business.”

[PART VIII—REPEALED]

[§§ 1101 to 1103. Repealed. Pub. L. 101–508, title XI, § 11801(a)(34), Nov. 5, 1990, 104 Stat. 1388–521]

Section 1101, added May 9, 1956, ch. 240, § 10(a), 70 Stat. 139; amended Oct. 2, 1976, Pub. L. 94–452, § 2(a), 90 Stat. 1503; Oct. 4, 1976, Pub. L. 94–455, title XIX, § 1906(b)(13)(A), 90 Stat. 1834; Oct. 19, 1982, Pub. L. 97–354, § 5(a)(34), 96 Stat. 1695, related to distributions of property pursuant to Bank Holding Company Act.

Section 1102, added May 9, 1956, ch. 240, § 10(a), 70 Stat. 143; amended Dec. 27, 1967, Pub. L. 90–225, § 1, 81 Stat. 730; Oct. 2, 1976, Pub. L. 94–452, § 2(a), 90 Stat. 1508; Oct. 4, 1976, Pub. L. 94–455, title XIX, § 1906(b)(13)(A), 90 Stat. 1834, related to basis of property acquired in distributions, periods of limitation, allocation of earnings and profits, and itemization of property.

Section 1103, added May 9, 1956, ch. 240, § 10(a), 70 Stat. 144; amended Oct. 2, 1976, Pub. L. 94–452, § 2(a), 90 Stat. 1509; Oct. 4, 1976, Pub. L. 94–455, title XIX, § 1906(b)(13)(A), 90 Stat. 1834, related to definitions for this part.

SAVINGS PROVISION

For provisions that nothing in repeal by Pub. L. 101–508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101–508, set out as a note under section 45K of this title.

[PART IX—REPEALED]

[§ 1111. Repealed. Pub. L. 94–455, title XIX, § 1901(a)(134), Oct. 4, 1976, 90 Stat. 1786]

Section, added Pub. L. 87–403, § 1(a), Feb. 2, 1962, 76 Stat. 4, related to distribution of stock pursuant to order enforcing antitrust laws.

Subchapter P—Capital Gains and Losses

Part

- I. Treatment of capital gains.
- II. Treatment of capital losses.
- III. General rules for determining capital gains and losses.
- IV. Special rules for determining capital gains and losses.
- V. Special rules for bonds and other debt instruments.
- VI. Treatment of certain passive foreign investment companies.

AMENDMENTS

1986—Pub. L. 99–514, title XII, § 1235(g), Oct. 22, 1986, 100 Stat. 2576, added item for part VI.

1984—Pub. L. 98–369, div. A, title I, § 42(b)(1), July 18, 1984, 98 Stat. 557, added item for part V.

PART I—TREATMENT OF CAPITAL GAINS

Sec.

- 1201. Alternative tax for corporations.
- 1202. Partial exclusion for gain from certain small business stock.

AMENDMENTS

2000—Pub. L. 106–554, § 1(a)(7) [title I, § 117(b)(3)], Dec. 21, 2000, 114 Stat. 2763, 2763A–604, substituted “Partial” for “50-percent” in item 1202.

1993—Pub. L. 103–66, title XIII, § 13113(d)(6), Aug. 10, 1993, 107 Stat. 430, added item 1202.

1986—Pub. L. 99–514, title III, § 301(b)(13), Oct. 22, 1986, 100 Stat. 2218, struck out item 1202 “Deduction for capital gains”.

1978—Pub. L. 95-600, title IV, § 401(b)(6), Nov. 6, 1978, 92 Stat. 2867, substituted “Alternative tax for corporations” for “Alternative tax” in item 1201.

§ 1201. Alternative tax for corporations

(a) General rule

If for any taxable year a corporation has a net capital gain and any rate of tax imposed by section 11, 511, or 831(a) or (b) (whichever is applicable) exceeds 35 percent (determined without regard to the last 2 sentences of section 11(b)(1)), then, in lieu of any such tax, there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

(1) a tax computed on the taxable income reduced by the amount of the net capital gain, at the rates and in the manner as if this subsection had not been enacted, plus

(2) a tax of 35 percent of the net capital gain (or, if less, taxable income).

(b) Special rate for qualified timber gains

(1) In general

If, for any taxable year ending after the date of the enactment of the Food, Conservation, and Energy Act of 2008 and beginning on or before the date which is 1 year after such date, a corporation has both a net capital gain and qualified timber gain—

(A) subsection (a) shall apply to such corporation for the taxable year without regard to whether the applicable tax rate exceeds 35 percent, and

(B) the tax computed under subsection (a)(2) shall be equal to the sum of—

(i) 15 percent of the least of—

- (I) qualified timber gain,
- (II) net capital gain, or
- (III) taxable income, plus

(ii) 35 percent of the excess (if any) of taxable income over the sum of the amounts for which a tax was determined under subsection (a)(1) and clause (i).

(2) Qualified timber gain

For purposes of this section, the term “qualified timber gain” means, with respect to any taxpayer for any taxable year, the excess (if any) of—

(A) the sum of the taxpayer’s gains described in subsections (a) and (b) of section 631 for such year, over

(B) the sum of the taxpayer’s losses described in such subsections for such year.

For purposes of subparagraphs (A) and (B), only timber held more than 15 years shall be taken into account.

(3) Computation for taxable years in which rate first applies or ends

In the case of any taxable year which includes either of the dates set forth in paragraph (1), the qualified timber gain for such year shall not exceed the qualified timber gain properly taken into account for—

(A) in the case of the taxable year including the date of the enactment of the Food, Conservation, and Energy Act of 2008, the portion of the year after such date, and

(B) in the case of the taxable year including the date which is 1 year after such date of enactment, the portion of the year on or before such later date.

(c) Cross references

For computation of the alternative tax—

(1) in the case of life insurance companies, see section 801(a)(2),

(2) in the case of regulated investment companies and their shareholders, see section 852(b)(3)(A) and (D), and

(3) in the case of real estate investment trusts, see section 857(b)(3)(A).

(Aug. 16, 1954, ch. 736, 68A Stat. 320; Mar. 13, 1956, ch. 83, § 5(7), 70 Stat. 49; Pub. L. 86-69, § 3(f)(2), June 25, 1959, 73 Stat. 140; Pub. L. 87-834, § 8(g)(3), Oct. 16, 1962, 76 Stat. 999; Pub. L. 91-172, title V, § 511(b), Dec. 30, 1969, 83 Stat. 635; Pub. L. 94-455, title XIX, § 1901(a)(135), (b)(33)(L), Oct. 4, 1976, 90 Stat. 1786, 1801; Pub. L. 95-600, title IV, §§ 401(a), 403(a), (b), Nov. 6, 1978, 92 Stat. 2866, 2868; Pub. L. 96-222, title I, § 104(a)(2)(B), (3)(A), Apr. 1, 1980, 94 Stat. 214, 215; Pub. L. 98-369, div. A, title II, § 211(b)(16), July 18, 1984, 98 Stat. 756; Pub. L. 99-514, title III, § 311(a), title X, § 1024(c)(14), Oct. 22, 1986, 100 Stat. 2219, 2408; Pub. L. 100-647, title I, § 1003(c)(1), title II, § 2004(l), Nov. 10, 1988, 102 Stat. 3384, 3606; Pub. L. 103-66, title XIII, § 13221(c)(2), Aug. 10, 1993, 107 Stat. 477; Pub. L. 104-188, title I, § 1703(f), Aug. 20, 1996, 110 Stat. 1876; Pub. L. 105-34, title III, § 314(a), Aug. 5, 1997, 111 Stat. 842; Pub. L. 110-234, title XV, § 15311(a), May 22, 2008, 122 Stat. 1502; Pub. L. 110-246, § 4(a), title XV, § 15311(a), June 18, 2008, 122 Stat. 1664, 2264.)

REFERENCES IN TEXT

The date of the enactment of the Food, Conservation, and Energy Act of 2008, referred to in subsec. (b)(1), (3), is the date of enactment of Pub. L. 110-246, which was approved June 18, 2008.

CODIFICATION

Pub. L. 110-234 and Pub. L. 110-246 made identical amendments to this section. The amendments by Pub. L. 110-234 were repealed by section 4(a) of Pub. L. 110-246.

AMENDMENTS

2008—Subsecs. (b), (c). Pub. L. 110-246 added subsec. (b) and redesignated former subsec. (b) as (c).

1997—Subsec. (a)(2). Pub. L. 105-34 inserted “(or, if less, taxable income)” after “capital gain”.

1996—Subsec. (a). Pub. L. 104-188 substituted “last 2 sentences” for “last sentence”.

1993—Subsec. (a). Pub. L. 103-66 substituted “35 percent” for “34 percent” in introductory provisions and in par. (2).

1988—Subsec. (a). Pub. L. 100-647, § 2004(l), substituted “section 11(b)(1)” for “section 11(b)”.

Pub. L. 100-647, § 1003(c)(1), substituted “section 831(a) or (b)” for “section 831(a)”.

1986—Subsec. (a). Pub. L. 99-514, § 1024(c)(14), which directed the amendment of subsec. (a) by substituting “831(a) or (b)” for “821(a) or (c) and 831(a)” could not be executed in view of amendment by section 311(a) of Pub. L. 99-514.

Pub. L. 99-514, § 311(a), amended subsec. (a) generally. Prior to amendment, subsec. (a), corporations, read as follows: “If for any taxable year a corporation has a net capital gain, then, in lieu of the tax imposed by sections 11, 511, 821(a) or (c) and 831(a), there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

“(1) a tax computed on the taxable income reduced by the amount of the net capital gain, at the rates and in the manner as if this subsection had not been enacted, plus

“(2) a tax of 28 percent of the net capital gain.”

Subsec. (b). Pub. L. 99-514, §311(a), amended subsec. (b) generally, substituting a comma for the semicolon at end of par. (1) and after “852(b)(3)(A) and (D)” in par. (2).

Subsec. (c). Pub. L. 99-514, §311(a), in amending section generally, struck out subsec. (c), transitional rule, which read as follows: “If for any taxable year ending after December 31, 1978, and beginning before January 1, 1980, a corporation has a net capital gain, then subsection (a) shall be applied by substituting for the language of paragraph (2) the following:

“(2)(A) a tax of 28 percent of the lesser of—

“(i) the net capital gain for the taxable year, or

“(ii) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year after December 31, 1978, plus

“(B) a tax of 30 percent of the excess of—

“(i) the net capital gains for the taxable year, over

“(ii) the amount of net capital gain taken into account under subparagraph (A).”

1984—Subsec. (b)(1). Pub. L. 98-369 substituted “section 801(a)(2)” for “section 802(a)(2)”.

1980—Subsec. (b). Pub. L. 96-222, §104(a)(2)(B)(i), substituted in subsec. (b), as subsec. (b) was in effect for taxable years beginning before Jan. 1, 1979, and prior to its repeal by Pub. L. 95-600 (see 1978 Amendment note below), “the excess of the net capital gain over the deduction under section 1202” for “50 percent of the net capital gain”.

Subsec. (c). Pub. L. 96-222, §104(a)(3)(A), substituted in heading “Transitional rule” for “Taxable years which include January 1, 1979”, in provisions preceding par. (2) “If for any taxable year ending after December 31, 1978, and beginning before January 1, 1980” for “If for any taxable year beginning before January 1, 1979, and ending after December 31, 1978”, and in par. (2)(A)(ii) “gain or loss properly taken into account for the portion of the taxable year” for “sales and exchanges”.

Pub. L. 96-222, §104(a)(2)(B)(ii), substituted in subsec. (c), as subsec. (c) was in effect for taxable years beginning before Jan. 1, 1979, and prior to its repeal by Pub. L. 95-600 (see 1978 Amendment note below), “the excess of the net capital gain over the deduction under section 1202” for “50 percent of the net capital gain”, redesignated cls. (A) and (B) as pars. (1) and (2), respectively, and in par. (2) as so redesignated, substituted “determined by multiplying the sum referred to in subsection (b)(2)(A) by a fraction” for “equal to 50 percent of the sum referred to in subsection (b)(2)(A)” and added subpars. (A) and (B).

1978—Pub. L. 95-600, §401(a)(3), inserted “for corporations” after “tax” in section catchline.

Subsec. (a)(2). Pub. L. 95-600, §403(a), substituted “28 percent” for “30 percent”.

Subsec. (b). Pub. L. 95-600, §401(a)(1), (2), redesignated subsec. (d) as (b). Former subsec. (b), relating to imposition of the alternative tax on other taxpayers, was struck out. See 1980 Amendment note above.

Subsec. (c). Pub. L. 95-600, §§401(a)(1), 403(b), added subsec. (c). Former subsec. (c), which related to computation of the alternative tax where the capital gain exceeds \$50,000, was struck out. See 1980 Amendment note above.

Subsec. (d). Pub. L. 95-600, §401(a)(2), redesignated subsec. (d) as (b).

1976—Subsec. (a). Pub. L. 94-455, §1901(a)(135)(A), substituted “net capital gain” for “net section 1201 gain” in three places, incorporated existing text in provisions designated par. (1), struck out prior par. (1) provision adding to the tax in the case of a taxable year beginning before Jan. 1, 1975—

(A) a tax of 25 percent of the lesser of—

(i) the amount of the subsec. (d) gain, or

(ii) the amount of the net section 1201 gain, and

(B) a tax of 30 percent (28 percent in the case of a taxable year beginning after Dec. 31, 1969, and before Jan. 1, 1971) of the excess (if any) of the net section 1201 gain over the subsec. (d) gain, and struck out from par. (2) introductory text “in the case of a taxable year beginning after December 31, 1974.”

Subsec. (b). Pub. L. 94-455, §1901(b)(33)(L), substituted “net capital gain” for “net section 1201 gain” in introductory text and in par. (1).

Subsec. (b)(2)(A). Pub. L. 94-455, §1901(a)(135)(C)(ii), substituted “the sum of the long-term capital gains for the taxable year, but not to exceed \$50,000 (\$25,000 in the case of a married individual filing a separate return)” for “the amount of the subsection (d) gain”.

Subsec. (b)(2)(B). Pub. L. 94-455, §1901(b)(33)(L), substituted “net capital gain” for “net section 1201 gain”.

Subsec. (b)(3). Pub. L. 94-455, §1901(a)(135)(C)(iii), (b)(33)(L), substituted “the sum referred to in subparagraph (A)” for “the amount of the subsection (d) gain” and “net capital gain” for “net section 1201 gain”.

Subsec. (c). Pub. L. 94-455, §1901(a)(135)(B), substituted in heading “where capital gain exceeds \$50,000” for “on capital gain in excess of subsection (d) gain”, struck out par. (1) designation, substituted “net capital gain” for “net section 1201 gain” and “50 percent of the sum referred to in subsection (b)(2)(A)” for “50 percent of the subsection (d) gain”, and struck out par. (2) limitation that the tax computed for purposes of subsec. (b) shall not exceed an amount equal to the following percentage of the excess of the net section 1201 gain over the subsec. (d) gain:

(A) 29½ percent, in the case of a taxable year beginning after Dec. 31, 1969, and before Jan. 1, 1971, or

(B) 32½ percent, in the case of a taxable year beginning after Dec. 31, 1971, and before Jan. 1, 1972.

Subsecs. (d), (e). Pub. L. 94-455, §1901(a)(135)(C)(i), redesignated subsec. (e) as (d) and struck out existing subsec. (d) defining “subsection (d) gain”.

1969—Subsec. (a). Pub. L. 91-172 substituted reference to net section 1201 gain for reference to the excess of the net long-term capital gain of a corporation over the net short-term capital loss, substituted “a tax computed on the taxable income reduced by the amount of the net section 1201 gain” for “a partial tax computed on the taxable income reduced by the taxable income reduced by the amount of such excess,” struck out reference to tax of an amount equal to 25 percent of excess or in the case of a taxable year beginning before Apr. 1, 1954 an amount equal to 26 percent of such excess without regard to section 21 of this title, and inserted, in the case of a taxable year beginning Jan. 1, 1975, a tax of 25 percent of the lesser of the amount of the subsec. (d) gain, or the amount of the net section 1201 gain, and a tax of 30 percent (28 percent in the case of a taxable year beginning after Dec. 31, 1969 and before Jan. 1, 1971) of the excess (if any) of the net section 1201 gain over the subsec. (d) gain, and in case of a taxable year beginning after Dec. 31, 1974, a tax of 30 percent of the net section 1201 gain.

Subsec. (b). Pub. L. 91-172 substituted reference to net section 1201 gain for reference to the excess of the net long-term capital gain over the net short-term capital loss, substituted “a tax computed on the taxable income reduced by an amount equal to 50 percent of the net section 1201 gain” for “a partial tax computed on the taxable income reduced by an amount equal to 50 percent of such excess,” struck out reference to tax of an amount equal to 25 percent of the excess of the net long-term capital gain over the net short-term capital loss, and inserted reference to a tax of 25 percent of the lesser of the amount of the subsec. (d) gain, or the amount of the net section 1201 gain, and if the amount of the net section 1201 gain exceeds the amount of the subsec. (d) gain, a tax computed as provided in subsec. (c) on such excess.

Subsec. (c). Pub. L. 91-172 added subsec. (c). Former subsec. (c) redesignated (e)(1).

Subsec. (d). Pub. L. 91-172 added subsec. (d).

Subsec. (e). Pub. L. 91-172 redesignated former subsec. (c) as par. (1) and added pars. (2) and (3).

1962—Subsec. (a). Pub. L. 87-834 substituted “section 821(a) or (c)” for section 821(a)(1) or (b)”.

1959—Subsec. (a). Pub. L. 86-69 struck out reference to section 802(a).

Subsec. (c). Pub. L. 86-69 added subsec. (c).

1956—Subsec. (a). Act Mar. 13, 1956, inserted reference to section 802(a).

EFFECTIVE DATE OF 2008 AMENDMENT

Amendment of this section and repeal of Pub. L. 110-234 by Pub. L. 110-246 effective May 22, 2008, the date of enactment of Pub. L. 110-234, except as otherwise provided, see section 4 of Pub. L. 110-246, set out as an Effective Date note under section 8701 of Title 7, Agriculture.

Amendment by section 15311(a) of Pub. L. 110-246 applicable to taxable years ending after June 18, 2008, see section 15311(d) of Pub. L. 110-246, set out as a note under section 55 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Section 314(b) of Pub. L. 105-34 provided that: “The amendment made by this section [amending this section] shall apply to taxable years ending after December 31, 1997.”

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 effective as if included in the provision of the Revenue Reconciliation Act of 1993, Pub. L. 103-66, §§ 13001-13444, to which such amendment relates, see section 1703(o) of Pub. L. 104-188, set out as a note under section 39 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103-66 applicable to taxable years beginning on or after Jan. 1, 1993, see section 13221(d) of Pub. L. 103-66, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by section 1003(c)(1) of Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

Amendment by section 2004(l) of Pub. L. 100-647 effective, except as otherwise provided, as if included in the provisions of the Revenue Act of 1987, Pub. L. 100-203, title X, to which such amendment relates, see section 2004(u) of Pub. L. 100-647, set out as a note under section 56 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Section 311(c) of Pub. L. 99-514, as amended by Pub. L. 100-647, title I, § 1003(c)(2), Nov. 10, 1988, 102 Stat. 3384, provided that: “The amendments made by subsections (a) and (b) [amending this section and sections 593, 631, 852, and 1445 of this title] shall apply to taxable years beginning after December 31, 1986; except that the amendment made by subsection (b)(4) [amending section 1445 of this title] shall apply to payments made after December 31, 1986.”

Amendment by section 1024 of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, see section 1024(e) of Pub. L. 99-514, set out as a note under section 831 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 applicable to taxable years beginning after Dec. 31, 1983, see section 215 of Pub. L. 98-369, set out as an Effective Date note under section 801 of this title.

EFFECTIVE DATE OF 1980 AMENDMENT

Amendment by section 104(a)(3)(A) of Pub. L. 96-222 effective, except as otherwise provided, as if it had been

included in the provisions of the Revenue Act of 1978, Pub. L. 95-600, to which such amendment relates, see section 201 of Pub. L. 96-222, set out as a note under section 32 of this title.

Section 104(b)(1) of Pub. L. 96-222 provided that: “The amendments made by subsection (a)(2)(B) [amending this section] shall apply to taxable years beginning in 1978.”

EFFECTIVE DATE OF 1978 AMENDMENT

Section 401(c) of Pub. L. 95-600 provided that: “The amendments made by this section [amending this section and sections 3, 5, 871, 911, and 1304 of this title] shall apply to taxable years beginning after December 31, 1978.”

Section 403(d)(1) of Pub. L. 95-600 provided that: “The amendments made by subsections (a) and (b) [amending this section] shall apply to taxable years ending after December 31, 1978.”

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by Pub. L. 94-455 applicable with respect to taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

EFFECTIVE DATE OF 1969 AMENDMENT

Section 511(d) of Pub. L. 91-172 provided that: “The amendments made by this section [amending this section and sections 802, 852, 857, and 1378 of this title] shall apply to taxable years beginning after December 31, 1969.”

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment by Pub. L. 87-834 applicable with respect to taxable years beginning after Dec. 31, 1962, see section 8(h) of Pub. L. 87-834, set out as a note under section 501 of this title.

EFFECTIVE DATE OF 1959 AMENDMENT

Amendment by Pub. L. 86-69 applicable only with respect to taxable years beginning after Dec. 31, 1957, see section 4 of Pub. L. 86-69, set out as a note under section 381 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Amendment by act Mar. 13, 1956, applicable only to taxable years beginning after Dec. 31, 1954, see section 6 of act Mar. 13, 1956, set out as a note under section 316 of this title.

TRANSITIONAL RULES

Section 311(d)(1) of Pub. L. 99-514 provided that:

“(1) TAXABLE YEARS WHICH BEGIN IN 1986 AND END IN 1987.—In the case of any taxable year which begins before January 1, 1987, and ends on or after such date, paragraph (2) of section 1201(a) of the Internal Revenue Code of 1954 [now 1986], as in effect on the date before the date of enactment of this Act [Oct. 22, 1986], shall be applied as if it read as follows:

“(2) the sum of—

“(A) 28 percent of the lesser of—

“(i) the net capital gain determined by taking into account only gain or loss which is properly taken into account for the portion of the taxable year before January 1, 1987, or

“(ii) the net capital gain for the taxable year, and

“(B) 34 percent of the excess (if any) of—

“(i) the net capital gain for the taxable year, over

“(ii) the amount of the net capital gain taken into account under subparagraph (A).”

RATE ON NET CAPITAL GAIN FOR PORTION OF 1981; 20-PERCENT MAXIMUM

Pub. L. 97-34, title I, § 102, Aug. 13, 1981, 95 Stat. 186, as amended by Pub. L. 97-448, title I, § 101(aa), Jan. 12,

1983, 96 Stat. 2366; Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(a) IN GENERAL.—If for any taxable year ending after June 9, 1981, and beginning before January 1, 1982, a taxpayer other than a corporation has qualified net capital gain, then the tax imposed under section 1 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] for such taxable year shall be equal to the lesser of—

“(1) the tax imposed under such section determined without regard to this subsection, or

“(2) the sum of—

“(A) the tax imposed under such section on the excess of—

“(i) the taxable income of the taxpayer, over

“(ii) 40 percent of the qualified net capital gain of the taxpayer, and

“(B) 20 percent of the qualified net capital gain.

“(b) APPLICATION WITH ALTERNATIVE MINIMUM TAX.—

“(1) IN GENERAL.—If subsection (a) applies to any taxpayer for any taxable year, then the amount determined under section 55(a)(1) of the Internal Revenue Code of 1986 for such taxable year shall be equal to the lesser of—

“(A) the amount determined under such section 55(a)(1) determined without regard to this subsection, or

“(B) the sum of—

“(i) the amount which would be determined under such section 55(a)(1) if the alternative minimum taxable income was the excess of—

“(I) the alternative minimum taxable income (within the meaning of section 55(b)(1) of such Code) of the taxpayer, over

“(II) the qualified net capital gain of the taxpayer, and

“(ii) 20 percent of the qualified net capital gain (or, if lesser, the alternative minimum taxable income within the meaning of section 55(b)(1) of such Code).

“(2) NO CREDITS ALLOWABLE.—For purposes of section 55(c) of such Code, no credit allowable under subpart A of part IV of subchapter A of chapter 1 of such Code [section 31 et seq. of this title] (other than section 33(a) of such Code) shall be allowable against the amount described in paragraph (1)(B)(ii).

“(c) QUALIFIED NET CAPITAL GAIN.—

“(1) IN GENERAL.—For purposes of this section, the term ‘qualified net capital gain’ means the lesser of—

“(A) the net capital gain for the taxable year, or

“(B) the net capital gain for the taxable year taking into account only gain or loss from sales or exchanges occurring after June 9, 1981.

“(2) NET CAPITAL GAIN.—For purposes of this subsection, the term ‘net capital gain’ has the meaning given such term by section 1222(1) of the Internal Revenue Code of 1986.

“(d) SPECIAL RULE FOR PASS-THRU ENTITIES.—

“(1) IN GENERAL.—In applying subsections (a), (b), and (c) with respect to any pass-thru entity, the determination of when a sale or exchange has occurred shall be made at the entity level.

“(2) PASS-THRU ENTITY DEFINED.—For purposes of paragraph (1), the term ‘pass-thru entity’ means—

“(A) a regulated investment company,

“(B) a real estate investment trust,

“(C) an electing small business corporation,

“(D) a partnership,

“(E) an estate or trust, and

“(F) a common trust fund.”

SPECIAL RULE FOR PASS-THROUGH ENTITIES

Section 104(a)(2)(C) of Pub. L. 96-222, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(i) IN GENERAL.—In applying sections 1201(c)(2)(A)(ii) and 1202(c)(1)(B) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] with respect to any pass-through entity, the determination of the period for which gain or loss is properly taken into account shall be made at the entity level.

“(ii) PASS-THROUGH ENTITY DEFINED.—For purposes of clause (i), the term ‘pass-through entity’ means—

“(I) a regulated investment company,

“(II) a real estate investment trust,

“(III) an electing small business corporation,

“(IV) a partnership,

“(V) an estate or trust, and

“(VI) a common trust fund.”

STUDY OF EFFECTS OF CHANGES IN THE TAX TREATMENT OF CAPITAL GAINS ON STIMULATING INVESTMENT AND ECONOMIC GROWTH

Section 555 of Pub. L. 95-600 required the Secretary of the Treasury to submit to specific committees of Congress a report, not later than Sept. 30, 1981, respecting effects of changes in tax treatment of capital gains on stimulating investment and economic growth as a result of the enactment of title V of Pub. L. 95-600.

§ 1202. Partial exclusion for gain from certain small business stock

(a) Exclusion

(1) In general

In the case of a taxpayer other than a corporation, gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than 5 years.

(2) Empowerment zone businesses

(A) In general

In the case of qualified small business stock acquired after the date of the enactment of this paragraph in a corporation which is a qualified business entity (as defined in section 1397C(b)) during substantially all of the taxpayer's holding period for such stock, paragraph (1) shall be applied by substituting “60 percent” for “50 percent”.

(B) Certain rules to apply

Rules similar to the rules of paragraphs (5) and (7) of section 1400B(b) shall apply for purposes of this paragraph.

(C) Gain after 2016 not qualified

Subparagraph (A) shall not apply to gain attributable to periods after December 31, 2016.

(D) Treatment of DC zone

The District of Columbia Enterprise Zone shall not be treated as an empowerment zone for purposes of this paragraph.

(3) Special rules for 2009 and certain periods in 2010

In the case of qualified small business stock acquired after the date of the enactment of this paragraph and on or before the date of the enactment of the Creating Small Business Jobs Act of 2010—

(A) paragraph (1) shall be applied by substituting “75 percent” for “50 percent”, and

(B) paragraph (2) shall not apply.

(4) 100 percent exclusion for stock acquired during certain periods in 2010 and 2011

In the case of qualified small business stock acquired after the date of the enactment of the Creating Small Business Jobs Act of 2010 and before January 1, 2012—

(A) paragraph (1) shall be applied by substituting “100 percent” for “50 percent”,

- (B) paragraph (2) shall not apply, and
- (C) paragraph (7) of section 57(a) shall not apply.

(b) Per-issuer limitation on taxpayer's eligible gain

(1) In general

If the taxpayer has eligible gain for the taxable year from 1 or more dispositions of stock issued by any corporation, the aggregate amount of such gain from dispositions of stock issued by such corporation which may be taken into account under subsection (a) for the taxable year shall not exceed the greater of—

(A) \$10,000,000 reduced by the aggregate amount of eligible gain taken into account by the taxpayer under subsection (a) for prior taxable years and attributable to dispositions of stock issued by such corporation, or

(B) 10 times the aggregate adjusted bases of qualified small business stock issued by such corporation and disposed of by the taxpayer during the taxable year.

For purposes of subparagraph (B), the adjusted basis of any stock shall be determined without regard to any addition to basis after the date on which such stock was originally issued.

(2) Eligible gain

For purposes of this subsection, the term “eligible gain” means any gain from the sale or exchange of qualified small business stock held for more than 5 years.

(3) Treatment of married individuals

(A) Separate returns

In the case of a separate return by a married individual, paragraph (1)(A) shall be applied by substituting “\$5,000,000” for “\$10,000,000”.

(B) Allocation of exclusion

In the case of any joint return, the amount of gain taken into account under subsection (a) shall be allocated equally between the spouses for purposes of applying this subsection to subsequent taxable years.

(C) Marital status

For purposes of this subsection, marital status shall be determined under section 7703.

(c) Qualified small business stock

For purposes of this section—

(1) In general

Except as otherwise provided in this section, the term “qualified small business stock” means any stock in a C corporation which is originally issued after the date of the enactment of the Revenue Reconciliation Act of 1993, if—

(A) as of the date of issuance, such corporation is a qualified small business, and

(B) except as provided in subsections (f) and (h), such stock is acquired by the taxpayer at its original issue (directly or through an underwriter)—

(i) in exchange for money or other property (not including stock), or

(ii) as compensation for services provided to such corporation (other than services performed as an underwriter of such stock).

(2) Active business requirement; etc.

(A) In general

Stock in a corporation shall not be treated as qualified small business stock unless, during substantially all of the taxpayer's holding period for such stock, such corporation meets the active business requirements of subsection (e) and such corporation is a C corporation.

(B) Special rule for certain small business investment companies

(i) Waiver of active business requirement

Notwithstanding any provision of subsection (e), a corporation shall be treated as meeting the active business requirements of such subsection for any period during which such corporation qualifies as a specialized small business investment company.

(ii) Specialized small business investment company

For purposes of clause (i), the term “specialized small business investment company” means any eligible corporation (as defined in subsection (e)(4)) which is licensed to operate under section 301(d) of the Small Business Investment Act of 1958 (as in effect on May 13, 1993).

(3) Certain purchases by corporation of its own stock

(A) Redemptions from taxpayer or related person

Stock acquired by the taxpayer shall not be treated as qualified small business stock if, at any time during the 4-year period beginning on the date 2 years before the issuance of such stock, the corporation issuing such stock purchased (directly or indirectly) any of its stock from the taxpayer or from a person related (within the meaning of section 267(b) or 707(b)) to the taxpayer.

(B) Significant redemptions

Stock issued by a corporation shall not be treated as qualified business stock if, during the 2-year period beginning on the date 1 year before the issuance of such stock, such corporation made 1 or more purchases of its stock with an aggregate value (as of the time of the respective purchases) exceeding 5 percent of the aggregate value of all of its stock as of the beginning of such 2-year period.

(C) Treatment of certain transactions

If any transaction is treated under section 304(a) as a distribution in redemption of the stock of any corporation, for purposes of subparagraphs (A) and (B), such corporation shall be treated as purchasing an amount of its stock equal to the amount treated as such a distribution under section 304(a).

(d) Qualified small business

For purposes of this section—

(1) In general

The term “qualified small business” means any domestic corporation which is a C corporation if—

(A) the aggregate gross assets of such corporation (or any predecessor thereof) at all times on or after the date of the enactment of the Revenue Reconciliation Act of 1993 and before the issuance did not exceed \$50,000,000,

(B) the aggregate gross assets of such corporation immediately after the issuance (determined by taking into account amounts received in the issuance) do not exceed \$50,000,000, and

(C) such corporation agrees to submit such reports to the Secretary and to shareholders as the Secretary may require to carry out the purposes of this section.

(2) Aggregate gross assets**(A) In general**

For purposes of paragraph (1), the term “aggregate gross assets” means the amount of cash and the aggregate adjusted bases of other property held by the corporation.

(B) Treatment of contributed property

For purposes of subparagraph (A), the adjusted basis of any property contributed to the corporation (or other property with a basis determined in whole or in part by reference to the adjusted basis of property so contributed) shall be determined as if the basis of the property contributed to the corporation (immediately after such contribution) were equal to its fair market value as of the time of such contribution.

(3) Aggregation rules**(A) In general**

All corporations which are members of the same parent-subsidiary controlled group shall be treated as 1 corporation for purposes of this subsection.

(B) Parent-subsidiary controlled group

For purposes of subparagraph (A), the term “parent-subsidiary controlled group” means any controlled group of corporations as defined in section 1563(a)(1), except that—

- (i) “more than 50 percent” shall be substituted for “at least 80 percent” each place it appears in section 1563(a)(1), and
- (ii) section 1563(a)(4) shall not apply.

(e) Active business requirement**(1) In general**

For purposes of subsection (c)(2), the requirements of this subsection are met by a corporation for any period if during such period—

(A) at least 80 percent (by value) of the assets of such corporation are used by such corporation in the active conduct of 1 or more qualified trades or businesses, and

(B) such corporation is an eligible corporation.

(2) Special rule for certain activities

For purposes of paragraph (1), if, in connection with any future qualified trade or business, a corporation is engaged in—

(A) start-up activities described in section 195(c)(1)(A),

(B) activities resulting in the payment or incurring of expenditures which may be treated as research and experimental expenditures under section 174, or

(C) activities with respect to in-house research expenses described in section 41(b)(4),

assets used in such activities shall be treated as used in the active conduct of a qualified trade or business. Any determination under this paragraph shall be made without regard to whether a corporation has any gross income from such activities at the time of the determination.

(3) Qualified trade or business

For purposes of this subsection, the term “qualified trade or business” means any trade or business other than—

(A) any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees,

(B) any banking, insurance, financing, leasing, investing, or similar business,

(C) any farming business (including the business of raising or harvesting trees),

(D) any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A, and

(E) any business of operating a hotel, motel, restaurant, or similar business.

(4) Eligible corporation

For purposes of this subsection, the term “eligible corporation” means any domestic corporation; except that such term shall not include—

(A) a DISC or former DISC,

(B) a corporation with respect to which an election under section 936 is in effect or which has a direct or indirect subsidiary with respect to which such an election is in effect,

(C) a regulated investment company, real estate investment trust, or REMIC, and

(D) a cooperative.

(5) Stock in other corporations**(A) Look-thru in case of subsidiaries**

For purposes of this subsection, stock and debt in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiary's assets, and to conduct its ratable share of the subsidiary's activities.

(B) Portfolio stock or securities

A corporation shall be treated as failing to meet the requirements of paragraph (1) for any period during which more than 10 percent of the value of its assets (in excess of liabilities) consists of stock or securities in other corporations which are not subsidiaries of such corporation (other than assets described in paragraph (6)).

(C) Subsidiary

For purposes of this paragraph, a corporation shall be considered a subsidiary if the parent owns more than 50 percent of the combined voting power of all classes of stock entitled to vote, or more than 50 percent in value of all outstanding stock, of such corporation.

(6) Working capital

For purposes of paragraph (1)(A), any assets which—

(A) are held as a part of the reasonably required working capital needs of a qualified trade or business of the corporation, or

(B) are held for investment and are reasonably expected to be used within 2 years to finance research and experimentation in a qualified trade or business or increases in working capital needs of a qualified trade or business,

shall be treated as used in the active conduct of a qualified trade or business. For periods after the corporation has been in existence for at least 2 years, in no event may more than 50 percent of the assets of the corporation qualify as used in the active conduct of a qualified trade or business by reason of this paragraph.

(7) Maximum real estate holdings

A corporation shall not be treated as meeting the requirements of paragraph (1) for any period during which more than 10 percent of the total value of its assets consists of real property which is not used in the active conduct of a qualified trade or business. For purposes of the preceding sentence, the ownership of, dealing in, or renting of real property shall not be treated as the active conduct of a qualified trade or business.

(8) Computer software royalties

For purposes of paragraph (1), rights to computer software which produces active business computer software royalties (within the meaning of section 543(d)(1)) shall be treated as an asset used in the active conduct of a trade or business.

(f) Stock acquired on conversion of other stock

If any stock in a corporation is acquired solely through the conversion of other stock in such corporation which is qualified small business stock in the hands of the taxpayer—

(1) the stock so acquired shall be treated as qualified small business stock in the hands of the taxpayer, and

(2) the stock so acquired shall be treated as having been held during the period during which the converted stock was held.

(g) Treatment of pass-thru entities**(1) In general**

If any amount included in gross income by reason of holding an interest in a pass-thru entity meets the requirements of paragraph (2)—

(A) such amount shall be treated as gain described in subsection (a), and

(B) for purposes of applying subsection (b), such amount shall be treated as gain from a disposition of stock in the corporation issuing the stock disposed of by the pass-thru

entity and the taxpayer's proportionate share of the adjusted basis of the pass-thru entity in such stock shall be taken into account.

(2) Requirements

An amount meets the requirements of this paragraph if—

(A) such amount is attributable to gain on the sale or exchange by the pass-thru entity of stock which is qualified small business stock in the hands of such entity (determined by treating such entity as an individual) and which was held by such entity for more than 5 years, and

(B) such amount is includible in the gross income of the taxpayer by reason of the holding of an interest in such entity which was held by the taxpayer on the date on which such pass-thru entity acquired such stock and at all times thereafter before the disposition of such stock by such pass-thru entity.

(3) Limitation based on interest originally held by taxpayer

Paragraph (1) shall not apply to any amount to the extent such amount exceeds the amount to which paragraph (1) would have applied if such amount were determined by reference to the interest the taxpayer held in the pass-thru entity on the date the qualified small business stock was acquired.

(4) Pass-thru entity

For purposes of this subsection, the term “pass-thru entity” means—

(A) any partnership,

(B) any S corporation,

(C) any regulated investment company, and

(D) any common trust fund.

(h) Certain tax-free and other transfers

For purposes of this section—

(1) In general

In the case of a transfer described in paragraph (2), the transferee shall be treated as—

(A) having acquired such stock in the same manner as the transferor, and

(B) having held such stock during any continuous period immediately preceding the transfer during which it was held (or treated as held under this subsection) by the transferor.

(2) Description of transfers

A transfer is described in this subsection if such transfer is—

(A) by gift,

(B) at death, or

(C) from a partnership to a partner of stock with respect to which requirements similar to the requirements of subsection (g) are met at the time of the transfer (without regard to the 5-year holding period requirement).

(3) Certain rules made applicable

Rules similar to the rules of section 1244(d)(2) shall apply for purposes of this section.

(4) Incorporations and reorganizations involving nonqualified stock**(A) In general**

In the case of a transaction described in section 351 or a reorganization described in section 368, if qualified small business stock is exchanged for other stock which would not qualify as qualified small business stock but for this subparagraph, such other stock shall be treated as qualified small business stock acquired on the date on which the exchanged stock was acquired.

(B) Limitation

This section shall apply to gain from the sale or exchange of stock treated as qualified small business stock by reason of subparagraph (A) only to the extent of the gain which would have been recognized at the time of the transfer described in subparagraph (A) if section 351 or 368 had not applied at such time. The preceding sentence shall not apply if the stock which is treated as qualified small business stock by reason of subparagraph (A) is issued by a corporation which (as of the time of the transfer described in subparagraph (A)) is a qualified small business.

(C) Successive application

For purposes of this paragraph, stock treated as qualified small business stock under subparagraph (A) shall be so treated for subsequent transactions or reorganizations, except that the limitation of subparagraph (B) shall be applied as of the time of the first transfer to which such limitation applied (determined after the application of the second sentence of subparagraph (B)).

(D) Control test

In the case of a transaction described in section 351, this paragraph shall apply only if, immediately after the transaction, the corporation issuing the stock owns directly or indirectly stock representing control (within the meaning of section 368(c)) of the corporation whose stock was exchanged.

(i) Basis rules

For purposes of this section—

(1) Stock exchanged for property

In the case where the taxpayer transfers property (other than money or stock) to a corporation in exchange for stock in such corporation—

(A) such stock shall be treated as having been acquired by the taxpayer on the date of such exchange, and

(B) the basis of such stock in the hands of the taxpayer shall in no event be less than the fair market value of the property exchanged.

(2) Treatment of contributions to capital

If the adjusted basis of any qualified small business stock is adjusted by reason of any contribution to capital after the date on which such stock was originally issued, in determining the amount of the adjustment by reason of such contribution, the basis of the contributed

property shall in no event be treated as less than its fair market value on the date of the contribution.

(j) Treatment of certain short positions**(1) In general**

If the taxpayer has an offsetting short position with respect to any qualified small business stock, subsection (a) shall not apply to any gain from the sale or exchange of such stock unless—

(A) such stock was held by the taxpayer for more than 5 years as of the first day on which there was such a short position, and

(B) the taxpayer elects to recognize gain as if such stock were sold on such first day for its fair market value.

(2) Offsetting short position

For purposes of paragraph (1), the taxpayer shall be treated as having an offsetting short position with respect to any qualified small business stock if—

(A) the taxpayer has made a short sale of substantially identical property,

(B) the taxpayer has acquired an option to sell substantially identical property at a fixed price, or

(C) to the extent provided in regulations, the taxpayer has entered into any other transaction which substantially reduces the risk of loss from holding such qualified small business stock.

For purposes of the preceding sentence, any reference to the taxpayer shall be treated as including a reference to any person who is related (within the meaning of section 267(b) or 707(b)) to the taxpayer.

(k) Regulations

The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of this section through split-ups, shell corporations, partnerships, or otherwise.

(Added Pub. L. 103-66, title XIII, §13113(a), Aug. 10, 1993, 107 Stat. 422; amended Pub. L. 104-188, title I, §1621(b)(7), Aug. 20, 1996, 110 Stat. 1867; Pub. L. 106-554, §1(a)(7) [title I, §117(a), (b)(2)], Dec. 21, 2000, 114 Stat. 2763, 2763A-604; Pub. L. 108-357, title VIII, §835(b)(9), Oct. 22, 2004, 118 Stat. 1594; Pub. L. 111-5, div. B, title I, §1241(a), Feb. 17, 2009, 123 Stat. 342; Pub. L. 111-240, title II, §2011(a), (b), Sept. 27, 2010, 124 Stat. 2554; Pub. L. 111-312, title VII, §§753(b), 760(a), Dec. 17, 2010, 124 Stat. 3321, 3323.)

REFERENCES IN TEXT

The date of the enactment of this paragraph, referred to in subsec. (a)(2)(A), is the date of enactment of Pub. L. 106-554, which was approved Dec. 21, 2000.

The date of the enactment of this paragraph, referred to in subsec. (a)(3), is the date of enactment of Pub. L. 111-5, which was approved Feb. 17, 2009.

The date of the enactment of the Creating Small Business Jobs Act of 2010, referred to in subsec. (a)(3), (4), is the date of enactment of Pub. L. 111-240, which was approved Sept. 27, 2010.

The date of the enactment of the Revenue Reconciliation Act of 1993, referred to in subsecs. (c)(1) and (d)(1)(A), is the date of enactment of Pub. L. 103-66, which was approved Aug. 10, 1993.

Section 301(d) of the Small Business Investment Act of 1958, referred to in subsec. (c)(2)(B)(ii), was classified to section 681(d) of Title 15, Commerce and Trade, prior to repeal by Pub. L. 104-208, div. D, title II, § 208(b)(3)(A), Sept. 30, 1996, 110 Stat. 3009-742.

PRIOR PROVISIONS

A prior section 1202, acts Aug. 16, 1954, ch. 736, 68A Stat. 320; Oct. 4, 1976, Pub. L. 94-455, title XIX, § 1901(b)(33)(M), 90 Stat. 1802; Nov. 6, 1978, Pub. L. 95-600, title IV, § 402(a), 92 Stat. 2867; Apr. 1, 1980, Pub. L. 96-222, title I, § 104(a)(2)(A), 94 Stat. 214, authorized deduction for capital gains, prior to repeal by Pub. L. 99-514, title III, § 301(a), (c), Oct. 22, 1986, 100 Stat. 2216, 2218, applicable to taxable years beginning after Dec. 31, 1986.

AMENDMENTS

2010—Subsec. (a)(2)(C). Pub. L. 111-312, § 753(b), substituted “2016” for “2014” in heading and “December 31, 2016” for “December 31, 2014” in text.

Subsec. (a)(3). Pub. L. 111-240, § 2011(b), inserted “certain periods in” before “2010” in heading and substituted “on or before the date of the enactment of the Creating Small Business Jobs Act of 2010” for “before January 1, 2011” in text.

Subsec. (a)(4). Pub. L. 111-312, § 760(a), inserted “and 2011” after “2010” in heading and substituted “January 1, 2012” for “January 1, 2011” in introductory provisions.

Pub. L. 111-240, § 2011(a), added par. (4).

2009—Subsec. (a)(3). Pub. L. 111-5 added par. (3).

2004—Subsec. (e)(4)(C). Pub. L. 108-357 substituted “or REMIC” for “REMIC, or FASIT”.

2000—Pub. L. 106-554, § 1(a)(7) [title I, § 117(b)(2)], substituted “Partial” for “50-percent” in section catchline.

Subsec. (a). Pub. L. 106-554, § 1(a)(7) [title I, § 117(a)], amended heading and text of subsec. (a) generally. Prior to amendment, text read as follows: “In the case of a taxpayer other than a corporation, gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than 5 years.”

1996—Subsec. (e)(4)(C). Pub. L. 104-188 substituted “REMIC, or FASIT” for “or REMIC”.

EFFECTIVE DATE OF 2010 AMENDMENT

Pub. L. 111-312, title VII, § 753(d), Dec. 17, 2010, 124 Stat. 3321, provided that: “The amendments made by this section [amending this section and section 1391 of this title] shall apply to periods after December 31, 2009.”

Pub. L. 111-312, title VII, § 760(b), Dec. 17, 2010, 124 Stat. 3323, provided that: “The amendments made by this section [amending this section] shall apply to stock acquired after December 31, 2010.”

Pub. L. 111-240, title II, § 2011(c), Sept. 27, 2010, 124 Stat. 2554, provided that: “The amendments made by this section [amending this section] shall apply to stock acquired after the date of the enactment of this Act [Sept. 27, 2010].”

EFFECTIVE DATE OF 2009 AMENDMENT

Pub. L. 111-5, div. B, title I, § 1241(b), Feb. 17, 2009, 123 Stat. 342, provided that: “The amendment made by this section [amending this section] shall apply to stock acquired after the date of the enactment of this Act [Feb. 17, 2009].”

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 effective Jan. 1, 2005, with exception for any FASIT in existence on Oct. 22, 2004, to the extent that regular interests issued by the FASIT before such date continue to remain outstanding in accordance with the original terms of issuance, see section 835(c) of Pub. L. 108-357, set out as a note under section 56 of this title.

EFFECTIVE DATE OF 2000 AMENDMENT

Amendment by Pub. L. 106-554 applicable to stock acquired after Dec. 21, 2000, see section 1(a)(7) [title I,

§ 117(c)] of Pub. L. 106-554, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 effective Sept. 1, 1997, see section 1621(d) of Pub. L. 104-188, set out as a note under section 26 of this title.

EFFECTIVE DATE

Section applicable to stock issued after Aug. 10, 1993, see section 13113(e) of Pub. L. 103-66, set out as an Effective Date of 1993 Amendment note under section 53 of this title.

PART II—TREATMENT OF CAPITAL LOSSES

Sec.

1211. Limitation on capital losses.

1212. Capital loss carrybacks and carryovers.

AMENDMENTS

1969—Pub. L. 91-172, title V, § 512(f)(2), Dec. 30, 1969, 83 Stat. 641, substituted “carrybacks and carryovers” for “carryover” in item 1212.

§ 1211. Limitation on capital losses

(a) Corporations

In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

(b) Other taxpayers

In the case of a taxpayer other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus (if such losses exceed such gains) the lower of—

- (1) \$3,000 (\$1,500 in the case of a married individual filing a separate return), or
- (2) the excess of such losses over such gains.

(Aug. 16, 1954, ch. 736, 68A Stat. 321; Pub. L. 91-172, title V, § 513(a), Dec. 30, 1969, 83 Stat. 642; Pub. L. 94-455, title V, § 501(b)(6), title XIV, § 1401(a), (b), Oct. 4, 1976, 90 Stat. 1559, 1731; Pub. L. 95-30, title I, § 102(b)(14), May 23, 1977, 91 Stat. 138; Pub. L. 99-514, title III, § 301(b)(10), Oct. 22, 1986, 100 Stat. 2217.)

AMENDMENTS

1986—Subsec. (b). Pub. L. 99-514 amended subsec. (b) generally, substituting present provisions for provisions which had declared in: par. (1), general rule for limitation on capital losses for taxpayer other than corporation; in par. (2), meaning of term “applicable amount”; and in par. (3), rule relating to computation of taxable income.

1977—Subsec. (b)(1)(A). Pub. L. 95-30 inserted “reduced (but not below zero) by the zero bracket amount” after “taxable year”.

1976—Subsec. (b)(1)(B). Pub. L. 94-455, § 1401(a), substituted “the applicable amount” for “\$1,000”.

Subsec. (b)(2). Pub. L. 94-455, § 1401(b), substituted provision relating to “applicable amount” for prior provision limiting amount of capital losses for married individuals and reading “In the case of a husband or wife who files a separate return, the amount specified in paragraph (1)(B) shall be \$500 in lieu of \$1,000.”

Subsec. (b)(3). Pub. L. 94-455, § 501(b)(6), struck out last sentence “If the taxpayer elects to pay the optional tax imposed by section 3, ‘taxable income’ as used in this subsection shall read as ‘adjusted gross income’.”

1969—Subsec. (b). Pub. L. 91-172 provided for only 50 percent of an individual’s long-term capital losses to be

offset against his ordinary income up to the \$1,000 limit although short-term capital losses continue to be fully deductible within the \$1,000 limit and the deduction of capital losses against ordinary income for married persons filing separate returns to be limited to \$500 for each spouse rather than the \$1,000 formerly allowed.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, see section 301(c) of Pub. L. 99-514, set out as a note under section 62 of this title.

EFFECTIVE DATE OF 1977 AMENDMENT

Amendment by Pub. L. 95-30 applicable to taxable years beginning after Dec. 31, 1976, see section 106(a) of Pub. L. 95-30, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by section 501(b)(6) of Pub. L. 94-455 applicable to taxable years beginning after Dec. 31, 1975, see section 508 of Pub. L. 94-455, set out as a note under section 3 of this title.

Section 1401(c) of Pub. L. 94-455 provided that: "The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 1976."

EFFECTIVE DATE OF 1969 AMENDMENT

Section 513(d) of Pub. L. 91-172 provided that: "The amendments made by this section [amending this section and sections 1212 and 1222 of this title] shall apply to taxable years beginning after December 31, 1969."

§ 1212. Capital loss carrybacks and carryovers

(a) Corporations

(1) In general

If a corporation has a net capital loss for any taxable year (hereinafter in this paragraph referred to as the "loss year"), the amount thereof shall be—

(A) a capital loss carryback to each of the 3 taxable years preceding the loss year, but only to the extent—

(i) such loss is not attributable to a foreign expropriation capital loss, and

(ii) the carryback of such loss does not increase or produce a net operating loss (as defined in section 172(c)) for the taxable year to which it is being carried back;

(B) except as provided in subparagraph (C), a capital loss carryover to each of the 5 taxable years succeeding the loss year; and

(C) a capital loss carryover to each of the 10 taxable years succeeding the loss year, but only to the extent such loss is attributable to a foreign expropriation loss,

and shall be treated as a short-term capital loss in each such taxable year. The entire amount of the net capital loss for any taxable year shall be carried to the earliest of the taxable years to which such loss may be carried, and the portion of such loss which shall be carried to each of the other taxable years to which such loss may be carried shall be the excess, if any, of such loss over the total of the capital gain net income for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the capital gain net income for any such prior taxable year shall be computed without regard

to the net capital loss for the loss year or for any taxable year thereafter. In the case of any net capital loss which cannot be carried back in full to a preceding taxable year by reason of clause (ii) of subparagraph (A), the capital gain net income for such prior taxable year shall in no case be treated as greater than the amount of such loss which can be carried back to such preceding taxable year upon the application of such clause (ii).

(2) Definitions and special rules

(A) Foreign expropriation capital loss defined

For purposes of this subsection, the term "foreign expropriation capital loss" means, for any taxable year, the sum of the losses taken into account in computing the net capital loss for such year which are—

(i) losses sustained directly by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing, or

(ii) losses (treated under section 165(g)(1) as losses from the sale or exchange of capital assets) from securities which become worthless by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing.

(B) Portion of loss attributable to foreign expropriation capital loss

For purposes of paragraph (1), the portion of any net capital loss for any taxable year attributable to a foreign expropriation capital loss is the amount of the foreign expropriation capital loss for such year (but not in excess of the net capital loss for such year).

(C) Priority of application

For purposes of paragraph (1), if a portion of a net capital loss for any taxable year is attributable to a foreign expropriation capital loss, such portion shall be considered to be a separate net capital loss for such year to be applied after the other portion of such net capital loss.

(3) Regulated investment companies

(A) In general

If a regulated investment company has a net capital loss for any taxable year—

(i) paragraph (1) shall not apply to such loss,

(ii) the excess of the net short-term capital loss over the net long-term capital gain for such year shall be a short-term capital loss arising on the first day of the next taxable year, and

(iii) the excess of the net long-term capital loss over the net short-term capital gain for such year shall be a long-term capital loss arising on the first day of the next taxable year.

(B) Coordination with general rule

If a net capital loss to which paragraph (1) applies is carried over to a taxable year of a regulated investment company—

(i) Losses to which this paragraph applies

Clauses (ii) and (iii) of subparagraph (A) shall be applied without regard to any amount treated as a short-term capital loss under paragraph (1).

(ii) Losses to which general rule applies

Paragraph (1) shall be applied by substituting “net capital loss for the loss year or any taxable year thereafter (other than a net capital loss to which paragraph (3)(A) applies)” for “net capital loss for the loss year or any taxable year thereafter”.

(4) Special rules on carrybacks

A net capital loss of a corporation shall not be carried back under paragraph (1)(A) to a taxable year—

(A) for which it is a regulated investment company (as defined in section 851), or

(B) for which it is a real estate investment trust (as defined in section 856).

(b) Other taxpayers**(1) In general**

If a taxpayer other than a corporation has a net capital loss for any taxable year—

(A) the excess of the net short-term capital loss over the net long-term capital gain for such year shall be a short-term capital loss in the succeeding taxable year, and

(B) the excess of the net long-term capital loss over the net short-term capital gain for such year shall be a long-term capital loss in the succeeding taxable year.

(2) Treatment of amounts allowed under section 1211(b)(1) or (2)**(A) In general**

For purposes of determining the excess referred to in subparagraph (A) or (B) of paragraph (1), there shall be treated as a short-term capital gain in the taxable year an amount equal to the lesser of—

(i) the amount allowed for the taxable year under paragraph (1) or (2) of section 1211(b), or

(ii) the adjusted taxable income for such taxable year.

(B) Adjusted taxable income

For purposes of subparagraph (A), the term “adjusted taxable income” means taxable income increased by the sum of—

(i) the amount allowed for the taxable year under paragraph (1) or (2) of section 1211(b), and

(ii) the deduction allowed for such year under section 151 or any deduction in lieu thereof.

For purposes of the preceding sentence, any excess of the deductions allowed for the taxable year over the gross income for such year shall be taken into account as negative taxable income.

(c) Carryback of losses from section 1256 contracts to offset prior gains from such contracts**(1) In general**

If a taxpayer (other than a corporation) has a net section 1256 contracts loss for the taxable year and elects to have this subsection apply to such taxable year, the amount of such net section 1256 contracts loss—

(A) shall be a carryback to each of the 3 taxable years preceding the loss year, and

(B) to the extent that, after the application of paragraphs (2) and (3), such loss is allowed as a carryback to any such preceding taxable year—

(i) 40 percent of the amount so allowed shall be treated as a short-term capital loss from section 1256 contracts, and

(ii) 60 percent of the amount so allowed shall be treated as a long-term capital loss from section 1256 contracts.

(2) Amount carried to each taxable year

The entire amount of the net section 1256 contracts loss for any taxable year shall be carried to the earliest of the taxable years to which such loss may be carried back under paragraph (1). The portion of such loss which shall be carried to each of the 2 other taxable years to which such loss may be carried back shall be the excess (if any) of such loss over the portion of such loss which, after the application of paragraph (3), was allowed as a carryback for any prior taxable year.

(3) Amount which may be used in any prior taxable year

An amount shall be allowed as a carryback under paragraph (1) to any prior taxable year only to the extent—

(A) such amount does not exceed the net section 1256 contract gain for such year, and

(B) the allowance of such carryback does not increase or produce a net operating loss (as defined in section 172(c)) for such year.

(4) Net section 1256 contracts loss

For purposes of paragraph (1), the term “net section 1256 contracts loss” means the lesser of—

(A) the net capital loss for the taxable year determined by taking into account only gains and losses from section 1256 contracts, or

(B) the sum of the amounts which, but for paragraph (6)(A), would be treated as capital losses in the succeeding taxable year under subparagraphs (A) and (B) of subsection (b)(1).

(5) Net section 1256 contract gain

For purposes of paragraph (1)—

(A) In general

The term “net section 1256 contract gain” means the lesser of—

(i) the capital gain net income for the taxable year determined by taking into account only gains and losses from section 1256 contracts, or

(ii) the capital gain net income for the taxable year.

(B) Special rule

The net section 1256 contract gain for any taxable year before the loss year shall be computed without regard to the net section 1256 contracts loss for the loss year or for any taxable year thereafter.

(6) Coordination with carryforward provisions of subsection (b)(1)**(A) Carryforward amount reduced by amount used as carryback**

For purposes of applying subsection (b)(1), if any portion of the net section 1256 contracts loss for any taxable year is allowed as a carryback under paragraph (1) to any preceding taxable year—

(i) 40 percent of the amount allowed as a carryback shall be treated as a short-term capital gain for the loss year, and

(ii) 60 percent of the amount allowed as a carryback shall be treated as a long-term capital gain for the loss year.

(B) Carryover loss retains character as attributable to section 1256 contract

Any amount carried forward as a short-term or long-term capital loss to any taxable year under subsection (b)(1) (after the application of subparagraph (A)) shall, to the extent attributable to losses from section 1256 contracts, be treated as loss from section 1256 contracts for such taxable year.

(7) Other definitions and special rules

For purposes of this subsection—

(A) Section 1256 contract

The term “section 1256 contract” means any section 1256 contract (as defined in section 1256(b)) to which section 1256 applies.

(B) Exclusion for estates and trusts

This subsection shall not apply to any estate or trust.

(Aug. 16, 1954, ch. 736, 68A Stat. 321; Pub. L. 88-272, title II, §230(a), Feb. 26, 1964, 78 Stat. 99; Pub. L. 88-571, §7(a), Sept. 2, 1964, 78 Stat. 860; Pub. L. 91-172, title V, §§512 (a), (b), (f)(1), 513(b), Dec. 30, 1969, 83 Stat. 638, 639, 641, 642; Pub. L. 94-455, title XIV, §1403 (a), title XIX, §1901(b)(33)(O), Oct. 4, 1976, 90 Stat. 1733, 1802; Pub. L. 95-600, title VII, §703(k), Nov. 6, 1978, 92 Stat. 2942; Pub. L. 97-34, title V, §504, Aug. 13, 1981, 95 Stat. 330; Pub. L. 97-354, §5(a)(35), Oct. 19, 1982, 96 Stat. 1695; Pub. L. 97-448, title I, §105(c)(7), Jan. 12, 1983, 96 Stat. 2387; Pub. L. 98-369, div. A, title I, §102(e)(3), title X, §1002(a), July 18, 1984, 98 Stat. 624, 1012; Pub. L. 99-514, title III, §301(b)(11), title XVIII, §1899A(67), Oct. 22, 1986, 100 Stat. 2218, 2962; Pub. L. 100-647, title I, §1003(a)(3), Nov. 10, 1988, 102 Stat. 3382; Pub. L. 108-357, title IV, §413(c)(20)(A), Oct. 22, 2004, 118 Stat. 1509; Pub. L. 111-325, title I, §101(a), (b)(1), Dec. 22, 2010, 124 Stat. 3538.)

AMENDMENTS

2010—Subsec. (a)(1)(C). Pub. L. 111-325, §101(b)(1), amended subpar. (C) generally. Prior to amendment, subpar. (C) read as follows: “a capital loss carryover—

“(i) in the case of a regulated investment company (as defined in section 851) to each of the 8 taxable years succeeding the loss year, and

“(ii) to the extent such loss is attributable to a foreign expropriation capital loss, to each of the 10 taxable years succeeding the loss year.”

Subsec. (a)(3), (4). Pub. L. 111-325, §101(a), added par. (3) and redesignated former par. (3) as (4).

2004—Subsec. (a)(3). Pub. L. 108-357 reenacted heading without change and amended text of par. (3) generally. Prior to amendment, par. (3) provided that a net capital loss of a corporation would not be carried back under par. (1)(A) to a taxable year for which it was a foreign personal holding company (as defined in section 552), for which it was a regulated investment company (as defined in section 851), for which it was a real estate investment trust (as defined in section 856), or for which an election made by it under section 1247 was applicable (relating to election by foreign investment companies to distribute income currently).

1988—Subsec. (b)(2). Pub. L. 100-647 substituted “Treatment of amounts allowed under section 1211(b)(1) or (2)” for “Special rule” as heading and amended text generally. Prior to amendment, text read as follows: “For purposes of determining the excess referred to in subparagraph (A) or (B) of paragraph (1), an amount equal to the amount allowed for the taxable year under paragraph (1) or (2) of section 1211(b) shall be treated as a short-term capital gain in such year.”

1986—Subsec. (b)(2). Pub. L. 99-514, §301(b)(11), amended par. (2) generally. Prior to amendment, par. (2), special rules, read as follows:

“(A) For purposes of determining the excess referred to in paragraph (1)(A), an amount equal to the amount allowed for the taxable year under section 1211(b)(1)(A), (B), or (C) shall be treated as a short-term capital gain in such year.

“(B) For purposes of determining the excess referred to in paragraph (1)(B), an amount equal to the sum of—

“(i) the amount allowed for the taxable year under section 1211(b)(1)(A), (B), or (C), and

“(ii) the excess of the amount described in clause (i) over the net short-term capital loss (determined without regard to this subsection) for such year, shall be treated as a short-term capital gain in such year.”

Subsec. (c)(6)(B), (7)(A). Pub. L. 99-514, §1899A(67), amended directory language of Pub. L. 98-369, §102(e)(3)(C), resulting in amendment of subsec. (c)(6)(B). See 1984 Amendment note below.

1984—Subsec. (b)(3). Pub. L. 98-369, §1002(a), struck out par. (3) which read as follows: “In the case of any amount which, under paragraph (1) and section 1211(b) (as in effect for taxable years beginning before January 1, 1970), is treated as a capital loss in the first taxable year beginning after December 31, 1969, paragraph (1) and section 1211(b) (as in effect for taxable years beginning before January 1, 1970) shall apply (and paragraph (1) and section 1211(b) as in effect for taxable years beginning after December 31, 1969, shall not apply) to the extent such amount exceeds the total of any net capital gains (determined without regard to this subsection) of taxable years beginning after December 31, 1969.”

Subsec. (c). Pub. L. 98-369, §102(e)(3)(A), (B), substituted “net section 1256 contracts loss” for “net commodity futures loss” and “section 1256 contracts” for “regulated futures contracts” wherever appearing.

Subsec. (c)(3)(A), (5). Pub. L. 98-369, §102(e)(3)(D), substituted “net section 1256 contract gain” for “net commodity futures gain” wherever appearing.

Subsec. (c)(6)(B), (7)(A). Pub. L. 98-369, §102(e)(3)(C), as amended by Pub. L. 99-514, §1899A(67), substituted “section 1256 contract” for “regulated futures contract” wherever appearing.

1983—Subsec. (c)(4)(A). Pub. L. 97-448 struck out “and positions to which section 1256 applies” after “losses from regulated futures contracts”.

1982—Subsec. (a)(3), (4). Pub. L. 97-354 struck out par. (3) relating to electing small business corporations, and redesignated par. (4) as (3).

1981—Subsec. (c). Pub. L. 97-34 added subsec. (c).

1978—Subsec. (a)(1)(C)(ii). Pub. L. 95-600 substituted “succeeding the loss year” for “exceeding the loss year”.

1976—Subsec. (a)(1). Pub. L. 94-455, §§1403(a), 1901(b)(33)(O), in subpar. (B) inserted introductory text “except as provided in subparagraph (C),” and struck out “(10) taxable years to the extent such loss is attributable to a foreign expropriation capital loss)” after “5 taxable years” and added subpar. (C), and substituted “capital gain net income” for “net capital gains”, “net capital gain” and “net capital gain” in last three sentences, respectively.

1969—Pub. L. 91-172, §512(f)(1), substituted “carrybacks and carryovers” for “carryover” in section catchline.

Subsec. (a)(1). Pub. L. 91-172, §512(a), provided for a 3-year capital loss carryback for corporations, not available for foreign expropriation capital losses for which a special 10-year carryforward is presently available, in addition to the 5-year capital loss carryforward presently allowed corporations, to the extent the carryback of such loss does not increase or produce a net operating loss for the taxable year to which it is being carried back.

Subsec. (a)(3), (4). Pub. L. 91-172, §512(b), added pars. (3) and (4).

Subsec. (b). Pub. L. 91-172, §513(b), struck out reference to Dec. 31, 1963, struck out determination of a short-term capital gain as an amount equal to the excess allowed for the taxable year under former section 1211(b) over the gains from sales or exchanges of capital assets, struck out par. (2) treating as a short-term capital loss in the first taxable year beginning after Dec. 31, 1963, any amount which is treated as a short-term capital loss in such year under this subchapter as in effect immediately before the enactment of the Revenue Act of 1964, added new par. (2) dealing with special rules for determining the excesses referred to in par. (1)(A) and par. (1)(B) and added par. (3).

1964—Subsec. (a). Pub. L. 88-571 provided that if any portion of a net capital loss is attributable to a foreign expropriation capital loss, such portion shall be a short-term capital loss in each of the 10 succeeding taxable years, defined foreign expropriation capital loss, stated what portion of loss is attributable to foreign expropriation capital loss and the priority of application of the net capital loss, and struck out provisions that net capital losses for taxable years beginning before Oct. 20, 1951, were to be determined under the applicable law relating to the computation of capital gains and losses in effect before such date.

Pub. L. 88-272 designated existing provisions as subsec. (a), limited such subsection to corporations, and added subsec. (b).

EFFECTIVE DATE OF 2010 AMENDMENT

Pub. L. 111-325, title I, §101(c), Dec. 22, 2010, 124 Stat. 3538, provided that:

“(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section [amending this section and section 1222 of this title] shall apply to net capital losses for taxable years beginning after the date of the enactment of this Act [Dec. 22, 2010].

“(2) COORDINATION RULES.—Subparagraph (B) of section 1212(a)(3) of the Internal Revenue Code of 1986, as added by this section, shall apply to taxable years beginning after the date of the enactment of this Act.”

EFFECTIVE DATE OF 2004 AMENDMENT

Pub. L. 108-357, title IV, §413(c)(20)(B), Oct. 22, 2004, 118 Stat. 1509, provided that: “The amendment made by subparagraph (A) [amending this section] shall apply to taxable years beginning after December 31, 2004.”

Amendment by Pub. L. 108-357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108-357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of

the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 301(b)(11) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, see section 301(c) of Pub. L. 99-514, set out as a note under section 62 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 102(e)(3) of Pub. L. 98-369 applicable to positions established after July 18, 1984, in taxable years after that date, except as otherwise provided, see section 102(f), (g) of Pub. L. 98-369, set out as a note under section 1256 of this title.

Section 1002(b) of Pub. L. 98-369 provided that: “The repeal made by subsection (a) [amending this section] shall apply to taxable years beginning after December 31, 1986.”

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by Pub. L. 97-448 effective, except as otherwise provided, as if it had been included in the provision of the Economic Recovery Tax Act of 1981, Pub. L. 97-34, to which such amendment relates, see section 109 of Pub. L. 97-448, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1982 AMENDMENT

Amendment by Pub. L. 97-354 applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as an Effective Date note under section 1361 of this title.

EFFECTIVE DATE OF 1981 AMENDMENT

Amendment by Pub. L. 97-34 applicable to property acquired and positions established by the taxpayer after June 23, 1981, in taxable years ending after such date, and applicable when so elected with respect to property held on June 23, 1981, see section 508 of Pub. L. 97-34, set out as an Effective Date note under section 1092 of this title.

EFFECTIVE DATE OF 1978 AMENDMENT

Amendment by Pub. L. 95-600 effective Oct. 4, 1976, see section 703(r) of Pub. L. 95-600, set out as a note under section 46 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Section 1403(b) of Pub. L. 94-455, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that: “The amendments made by this section [amending this section] shall apply to loss years (within the meaning of section 1212(a)(1) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954]) ending on or after January 1, 1970.”

Amendment by section 1901(b)(33)(O) of Pub. L. 94-455 applicable with respect to taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

EFFECTIVE DATE OF 1969 AMENDMENT

Section 512(g) of Pub. L. 91-172 provided that: “The amendments made by this section [amending this section and sections 246, 381, 481, 535, 1314, 6411, 6501, 6511, 6601, and 6611 of this title] shall apply with respect to net capital losses sustained in taxable years beginning after December 31, 1969.”

Amendment by section 513(b) of Pub. L. 91-172 applicable to taxable years beginning after Dec. 31, 1969, see section 513(d) of Pub. L. 91-172, set out as a note under section 1211 of this title.

EFFECTIVE DATE OF 1964 AMENDMENTS

Section 7(b) of Pub. L. 88-571, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that: “The amendment made by subsection (a) [amending

this section] shall apply with respect to net capital losses (to the extent attributable to foreign expropriation capital losses, as defined in section 1212(a)(2)(A) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954]) sustained in taxable years ending after December 31, 1958.”

Section 230(c) of Pub. L. 88-272 provided that: “The amendments made by this section [amending this section and section 1222 of this title] shall apply to taxable years beginning after December 31, 1963.”

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

ELECTION NOT TO CARRYBACK CERTAIN NET CAPITAL
LOSSES

Pub. L. 91-688, § 3, Jan. 12, 1971, 84 Stat. 2073, as amended by Pub. L. 99-514, § 2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(a) For purposes of applying section 1212(a) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as amended by section 512 of the Tax Reform Act of 1969) in the case of a corporation which makes an election under subsection (b), any net capital loss sustained in a taxable year beginning after December 31, 1969, may not be carried back to any taxable year beginning before January 1, 1970, for which it was subject to taxation under section 802 of such Code [section 802 of this title], if the carryback of such loss would result in an increase in such corporation's income tax liability for any such taxable year.

“(b) An election to have the provisions of subsection (a) apply shall be made by a corporation—

“(1) in such form and manner as the Secretary of the Treasury or his delegate may prescribe, and

“(2) not later than the time prescribed by law for filing a claim for credit or refund of overpayment of income tax for the first taxable year beginning after December 31, 1969, in which such corporation sustains a net capital loss.

“(c) The Secretary of the Treasury or his delegate shall prescribe such regulations as he determines necessary to carry out the purposes of this section.”

PART III—GENERAL RULES FOR DETERMINING
CAPITAL GAINS AND LOSSES

Sec.	
1221.	Capital asset defined.
1222.	Other items relating to capital gains and losses. ¹
1223.	Holding period of property.

§ 1221. Capital asset defined

(a) In general

For purposes of this subtitle, the term “capital asset” means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance

for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by—

(A) a taxpayer whose personal efforts created such property,

(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1);

(5) a publication of the United States Government (including the Congressional Record) which is received from the United States Government or any agency thereof, other than by purchase at the price at which it is offered for sale to the public, and which is held by—

(A) a taxpayer who so received such publication, or

(B) a taxpayer in whose hands the basis of such publication is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such publication in the hands of a taxpayer described in subparagraph (A);

(6) any commodities derivative financial instrument held by a commodities derivatives dealer, unless—

(A) it is established to the satisfaction of the Secretary that such instrument has no connection to the activities of such dealer as a dealer, and

(B) such instrument is clearly identified in such dealer's records as being described in subparagraph (A) before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may by regulations prescribe);

(7) any hedging transaction which is clearly identified as such before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may by regulations prescribe); or

(8) supplies of a type regularly used or consumed by the taxpayer in the ordinary course of a trade or business of the taxpayer.

(b) Definitions and special rules

(1) Commodities derivative financial instruments

For purposes of subsection (a)(6)—

(A) Commodities derivatives dealer

The term “commodities derivatives dealer” means a person which¹ regularly offers to enter into, assume, offset, assign, or terminate positions in commodities derivative

¹ So in original. Does not conform to section catchline.

¹ So in original. Probably should be “who”.

financial instruments with customers in the ordinary course of a trade or business.

(B) Commodities derivative financial instrument

(i) In general

The term “commodities derivative financial instrument” means any contract or financial instrument with respect to commodities (other than a share of stock in a corporation, a beneficial interest in a partnership or trust, a note, bond, debenture, or other evidence of indebtedness, or a section 1256 contract (as defined in section 1256(b))), the value or settlement price of which is calculated by or determined by reference to a specified index.

(ii) Specified index

The term “specified index” means any one or more or any combination of—

- (I) a fixed rate, price, or amount, or
- (II) a variable rate, price, or amount,

which is based on any current, objectively determinable financial or economic information with respect to commodities which is not within the control of any of the parties to the contract or instrument and is not unique to any of the parties’ circumstances.

(2) Hedging transaction

(A) In general

For purposes of this section, the term “hedging transaction” means any transaction entered into by the taxpayer in the normal course of the taxpayer’s trade or business primarily—

- (i) to manage risk of price changes or currency fluctuations with respect to ordinary property which is held or to be held by the taxpayer,
- (ii) to manage risk of interest rate or price changes or currency fluctuations with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, by the taxpayer, or
- (iii) to manage such other risks as the Secretary may prescribe in regulations.

(B) Treatment of nonidentification or improper identification of hedging transactions

Notwithstanding subsection (a)(7), the Secretary shall prescribe regulations to properly characterize any income, gain, expense, or loss arising from a transaction—

- (i) which is a hedging transaction but which was not identified as such in accordance with subsection (a)(7), or
- (ii) which was so identified but is not a hedging transaction.

(3) Sale or exchange of self-created musical works

At the election of the taxpayer, paragraphs (1) and (3) of subsection (a) shall not apply to musical compositions or copyrights in musical works sold or exchanged by a taxpayer described in subsection (a)(3).

(4) Regulations

The Secretary shall prescribe such regulations as are appropriate to carry out the pur-

poses of paragraph (6) and (7) of subsection (a) in the case of transactions involving related parties.

(Aug. 16, 1954, ch. 736, 68A Stat. 321; Pub. L. 91-172, title V, §514(a), Dec. 30, 1969, 83 Stat. 643; Pub. L. 94-455, title XIX, §1901(c)(9), title XXI, §2132(a), Oct. 4, 1976, 90 Stat. 1803, 1925; Pub. L. 97-34, title V, §505(a), Aug. 13, 1981, 95 Stat. 331; Pub. L. 106-170, title V, §532(a), Dec. 17, 1999, 113 Stat. 1928; Pub. L. 107-16, title V, §542(e)(2)(A), June 7, 2001, 115 Stat. 85; Pub. L. 107-147, title IV, §417(20), Mar. 9, 2002, 116 Stat. 57; Pub. L. 109-222, title II, §204(a), May 17, 2006, 120 Stat. 350; Pub. L. 109-432, div. A, title IV, §412(a), Dec. 20, 2006, 120 Stat. 2963; Pub. L. 111-312, title III, §301(a), Dec. 17, 2010, 124 Stat. 3300.)

AMENDMENT OF SECTION

For termination of amendment by section 304 of Pub. L. 111-312, see Effective and Termination Dates of 2010 Amendment note below.

For termination of amendment by section 901 of Pub. L. 107-16, see Effective and Termination Dates of 2001 Amendment note below.

AMENDMENTS

2010—Subsec. (a)(3)(C). Pub. L. 111-312, §§301(a), 304, temporarily amended subsec. (a)(3)(C) to read as if amendment by Pub. L. 107-16, §542(e)(2)(A), had never been enacted. See 2001 Amendment note and Effective and Termination Dates of 2010 Amendment note below.

2006—Subsec. (b)(3). Pub. L. 109-432 struck out “before January 1, 2011,” after “exchanged”.

Pub. L. 109-222 added par. (3). Former par. (3) redesignated (4).

Subsec. (b)(4). Pub. L. 109-222 redesignated par. (3) as (4).

2002—Subsec. (b)(1)(B)(i). Pub. L. 107-147 substituted “1256(b))” for “1256(b))”.

2001—Subsec. (a)(3)(C). Pub. L. 107-16, §§542(e)(2)(A), 901, temporarily inserted “(other than by reason of section 1022)” after “is determined”. See Effective and Termination Dates of 2001 Amendment note below.

1999—Pub. L. 106-170 designated existing provisions as subsec. (a), inserted heading, and added pars. (6) to (8) and subsec. (b).

1981—Pars. (5), (6). Pub. L. 97-34 redesignated par. (6) as (5) and struck out former par. (5), which excluded from definition of “capital asset” an obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, and is covered by section 1232(a)(4)(B) of this title.

1976—Par. (5). Pub. L. 94-455, §1901(c)(9), struck out “or Territory,” after “State”.

Par. (6). Pub. L. 94-455, §2132(a), added par. (6).

1969—Par. (3). Pub. L. 91-172 inserted reference to a letter or memorandum, added subpar. (B) dealing with a letter or memorandum, and redesignated former subpar. (B) as (C).

EFFECTIVE AND TERMINATION DATES OF 2010 AMENDMENT

Amendment by Pub. L. 111-312 applicable to estates of decedents dying, and transfers made after Dec. 31, 2009, except as otherwise provided, see section 301(e) of Pub. L. 111-312, set out as a note under section 121 of this title.

Section 901 of Pub. L. 107-16 applicable to amendments by section 301(a) of Pub. L. 111-312, see section 304 of Pub. L. 111-312, set out as a note under section 121 of this title.

EFFECTIVE DATE OF 2006 AMENDMENT

Pub. L. 109-432, div. A, title IV, §412(b), Dec. 20, 2006, 120 Stat. 2963, provided that: “The amendment made by

this section [amending this section] shall take effect as if included in section 204 of the Tax Increase Prevention and Reconciliation Act of 2005 [Pub. L. 109-222].”

Amendment by Pub. L. 109-222 applicable to sales and exchanges in taxable years beginning after May 17, 2006, see section 204(c) of Pub. L. 109-222, set out as a note under section 170 of this title.

EFFECTIVE AND TERMINATION DATES OF 2001 AMENDMENT

Amendment by Pub. L. 107-16 applicable to estates of decedents dying after Dec. 31, 2009, see section 542(f)(1) of Pub. L. 107-16, set out as a note under section 121 of this title.

Amendment by Pub. L. 107-16 inapplicable to estates of decedents dying, gifts made, or generation skipping transfers, after Dec. 31, 2012, and the Internal Revenue Code of 1986 to be applied and administered to such estates, gifts, and transfers as if such amendment had never been enacted, see section 901 of Pub. L. 107-16, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1999 AMENDMENT

Amendment by Pub. L. 106-170 applicable to any instrument held, acquired, or entered into, any transaction entered into, and supplies held or acquired on or after Dec. 17, 1999, see section 532(d) of Pub. L. 106-170, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 1981 AMENDMENT

Amendment by Pub. L. 97-34 applicable to property acquired and positions established by the taxpayer after June 23, 1981, in taxable years ending after such date, and applicable when so elected with respect to property held on June 23, 1981, see section 508 of Pub. L. 97-34, set out as an Effective Date note under section 1092 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Section 2132(b) of Pub. L. 94-455 provided that: “The amendment made by subsection (a) [amending this section] shall apply to sales, exchanges, and contributions made after the date of enactment of this Act [Oct. 4, 1976].”

EFFECTIVE DATE OF 1969 AMENDMENT

Section 514(c) of Pub. L. 91-172 provided that: “The amendments made by this section [amending this section and sections 341 and 1231 of this title] shall apply to sales and other dispositions occurring after July 25, 1969.”

§ 1222. Other terms relating to capital gains and losses

For purposes of this subtitle—

(1) Short-term capital gain

The term “short-term capital gain” means gain from the sale or exchange of a capital asset held for not more than 1 year, if and to the extent such gain is taken into account in computing gross income.

(2) Short-term capital loss

The term “short-term capital loss” means loss from the sale or exchange of a capital asset held for not more than 1 year, if and to the extent that such loss is taken into account in computing taxable income.

(3) Long-term capital gain

The term “long-term capital gain” means gain from the sale or exchange of a capital asset held for more than 1 year, if and to the extent such gain is taken into account in computing gross income.

(4) Long-term capital loss

The term “long-term capital loss” means loss from the sale or exchange of a capital asset held for more than 1 year, if and to the extent that such loss is taken into account in computing taxable income.

(5) Net short-term capital gain

The term “net short-term capital gain” means the excess of short-term capital gains for the taxable year over the short-term capital losses for such year.

(6) Net short-term capital loss

The term “net short-term capital loss” means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year.

(7) Net long-term capital gain

The term “net long-term capital gain” means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year.

(8) Net long-term capital loss

The term “net long-term capital loss” means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

(9) Capital gain net income

The term “capital gain net income” means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges.

(10) Net capital loss

The term “net capital loss” means the excess of the losses from sales or exchanges of capital assets over the sum allowed under section 1211. In the case of a corporation, for the purpose of determining losses under this paragraph, amounts which are short-term capital losses under section 1212(a)(1) shall be excluded.

(11) Net capital gain

The term “net capital gain” means the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year.

For purposes of this subtitle, in the case of futures transactions in any commodity subject to the rules of a board of trade or commodity exchange, the length of the holding period taken into account under this section or under any other section amended by section 1402 of the Tax Reform Act of 1976 shall be determined without regard to the amendments made by subsections (a) and (b) of such section 1402.

(Aug. 16, 1954, ch. 736, 68A Stat. 322; Pub. L. 88-272, title II, §230(b), Feb. 26, 1964, 78 Stat. 100; Pub. L. 91-172, title V, §§511(a), 513(c), Dec. 30, 1969, 83 Stat. 635, 643; Pub. L. 94-455, title XIV, §1402(a)(1), (2), (d), title XIX, §1901(a)(136), Oct. 4, 1976, 90 Stat. 1731, 1733, 1787; Pub. L. 98-369, div. A, title X, §1001(a), (e), July 18, 1984, 98 Stat. 1011, 1012; Pub. L. 111-325, title I, §101(b)(2), Dec. 22, 2010, 124 Stat. 3538.)

REFERENCES IN TEXT

The Tax Reform Act of 1976, referred to in last sentence, is Pub. L. 94-455, Oct. 4, 1976, 90 Stat. 1520, as

amended. For complete classification of this Act and of section 1402 of such Act to the Code, see Tables.

AMENDMENTS

2010—Par. (10). Pub. L. 111-325 substituted “section 1212(a)(1)” for “section 1212”.

1984—Pars. (1) to (4). Pub. L. 98-369 substituted “6 months” for “1 year”, applicable to property acquired after June 22, 1984, and before Jan. 1, 1988. See Effective Date of 1984 Amendment note below.

1976—Pars. (1) to (4). Pub. L. 94-455, §1402(a)(2), provided that “9 months” would be changed to “1 year”.

Pub. L. 94-455, §1402(a)(1), provided that “6 months” would be changed to “9 months” for taxable years beginning in 1977.

Par. (9). Pub. L. 94-455, §1901(a)(136)(A), substituted “Capital gain net income” and “capital gain net income” for “Net capital gain” and “net capital gain” in heading and text.

Par. (11). Pub. L. 94-455, §1901(a)(136)(B), substituted “Net capital gain” and “net capital gain” for “Net section 1201 gain” and “net section 1201 gain” in heading and text.

Pub. L. 94-455, §1402(d), inserted sentence at end relating to length of holding period in case of futures transactions in commodities.

1969—Par. (9). Pub. L. 91-172, §513(c), substituted “The” for “In the case of a corporation, the”.

Par. (11). Pub. L. 91-172, §511(a), added par. (11).

1964—Pars. (9), (10). Pub. L. 88-272 struck out provisions from par. (9) relating to taxpayers other than corporations, and inserted “In the case of a corporation” in par. (10).

EFFECTIVE DATE OF 2010 AMENDMENT

Amendment by Pub. L. 111-325 applicable to net capital losses for taxable years beginning after Dec. 22, 2010, see section 101(c)(1) of Pub. L. 111-325, set out as a note under section 1212 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 applicable to property acquired after June 22, 1984, and before Jan. 1, 1988, see section 1001(e) of Pub. L. 98-369, set out as a note under section 166 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Section 1402(a)(1) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning in 1977.

Section 1402(a)(2) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning after Dec. 31, 1977.

Amendment by section 1901(a)(136) of Pub. L. 94-455 applicable with respect to taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by section 513(c) of Pub. L. 91-172 applicable to taxable years beginning after Dec. 31, 1969, see section 513(d) of Pub. L. 91-172, set out as a note under section 1211 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment by Pub. L. 88-272 applicable to taxable years beginning after Dec. 31, 1963, see section 230(c) of Pub. L. 88-272, set out as a note under section 1212 of this title.

§ 1223. Holding period of property

For purposes of this subtitle—

(1) In determining the period for which the taxpayer has held property received in an exchange, there shall be included the period for which he held the property exchanged if, under this chapter, the property has, for the purpose

of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged, and, in the case of such exchanges after March 1, 1954, the property exchanged at the time of such exchange was a capital asset as defined in section 1221 or property described in section 1231. For purposes of this paragraph—

(A) an involuntary conversion described in section 1033 shall be considered an exchange of the property converted for the property acquired, and

(B) a distribution to which section 355 (or so much of section 356 as relates to section 355) applies shall be treated as an exchange.

(2) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under this chapter such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(3) In determining the period for which the taxpayer has held stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 1091 relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, there shall be included the period for which he held the stock or securities the loss from the sale or other disposition of which was not deductible.

(4) In determining the period for which the taxpayer has held stock or rights to acquire stock received on a distribution, if the basis of such stock or rights is determined under section 307 (or under so much of section 1052(c) as refers to section 113(a)(23) of the Internal Revenue Code of 1939), there shall (under regulations prescribed by the Secretary) be included the period for which he held the stock in the distributing corporation before the receipt of such stock or rights upon such distribution.

(5) In determining the period for which the taxpayer has held stock or securities acquired from a corporation by the exercise of rights to acquire such stock or securities, there shall be included only the period beginning with the date on which the right to acquire was exercised.

(6) In determining the period for which the taxpayer has held a residence, the acquisition of which resulted under section 1034 (as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997) in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, there shall be included the period for which such other residence had been held as of the date of such sale or exchange. For purposes of this paragraph, the term “sale or exchange” includes an involuntary conversion occurring after December 31, 1950, and before January 1, 1954.

(7) In determining the period for which the taxpayer has held a commodity acquired in satisfaction of a commodity futures contract (other than a commodity futures contract to

which section 1256 applies) there shall be included the period for which he held the commodity futures contract if such commodity futures contract was a capital asset in his hands.

(8) Any reference in this section to a provision of this title shall, where applicable, be deemed a reference to the corresponding provision of the Internal Revenue Code of 1939, or prior internal revenue laws.

(9) In the case of a person acquiring property from a decedent or to whom property passed from a decedent (within the meaning of section 1014(b)), if—

(A) the basis of such property in the hands of such person is determined under section 1014, and

(B) such property is sold or otherwise disposed of by such person within 1 year after the decedent's death,

then such person shall be considered to have held such property for more than 1 year.

(10) If—

(A) property is acquired by any person in a transfer to which section 1040 applies,

(B) such property is sold or otherwise disposed of by such person within 1 year after the decedent's death, and

(C) such sale or disposition is to a person who is a qualified heir (as defined in section 2032A(e)(1)) with respect to the decedent,

then the person making such sale or other disposition shall be considered to have held such property for more than 1 year.

(11) In determining the period for which the taxpayer has held qualified replacement property (within the meaning of section 1042(b)) the acquisition of which resulted under section 1042 in the nonrecognition of any part of the gain realized on the sale of qualified securities (within the meaning of section 1042(b)), there shall be included the period for which such qualified securities had been held by the taxpayer.

(12) In determining the period for which the taxpayer has held property the acquisition of which resulted under section 1043 in the nonrecognition of any part of the gain realized on the sale of other property, there shall be included the period for which such other property had been held as of the date of such sale.

(13) Except for purposes of sections 1202(a)(2), 1202(c)(2)(A), 1400B(b), and 1400F(b), in determining the period for which the taxpayer has held property the acquisition of which resulted under section 1045 or 1397B in the nonrecognition of any part of the gain realized on the sale of other property, there shall be included the period for which such other property has been held as of the date of such sale.

(14) If the security to which a securities futures contract (as defined in section 1234B) relates (other than a contract to which section 1256 applies) is acquired in satisfaction of such contract, in determining the period for which the taxpayer has held such security, there shall be included the period for which the taxpayer held such contract if such contract was a capital asset in the hands of the taxpayer.

(15) CROSS REFERENCE.—

For special holding period provision relating to certain partnership distributions, see section 735(b).

(Aug. 16, 1954, ch. 736, 68A Stat. 323; Pub. L. 87-834, §14(b)(3), Oct. 16, 1962, 76 Stat. 1041; Pub. L. 91-614, title I, §101(g), Dec. 31, 1970, 84 Stat. 1838; Pub. L. 94-455, title XIV, §1402(b)(1)(Q), (2), title XIX, §1906(b) (13)(A), Oct. 4, 1976, 90 Stat. 1732, 1834; Pub. L. 95-600, title VII, §702(c)(5), Nov. 6, 1978, 92 Stat. 2927; Pub. L. 96-223, title IV, §401(a), Apr. 2, 1980, 94 Stat. 299; Pub. L. 97-448, title I, §§104(b)(3)(C), 105(c)(4), Jan. 12, 1983, 96 Stat. 2382, 2385; Pub. L. 98-369, div. A, title I, §54(c), title V, §541(b)(1), title X, §1001(b)(14), (e), July 18, 1984, 98 Stat. 569, 890, 1011, 1012; Pub. L. 100-647, title I, §1006(e)(17), Nov. 10, 1988, 102 Stat. 3403; Pub. L. 101-194, title V, §502(b)(1), Nov. 30, 1989, 103 Stat. 1754; Pub. L. 105-34, title III, §§312(d)(9), 313(b)(2), Aug. 5, 1997, 111 Stat. 840, 842; Pub. L. 105-206, title V, §5001(a)(5), title VI, §6005(d)(4), July 22, 1998, 112 Stat. 788, 805; Pub. L. 106-554, §1(a)(7) [title I, §116(b)(2), title IV, §401(h)(1)], Dec. 21, 2000, 114 Stat. 2763, 2763A-603, 2763A-650; Pub. L. 108-357, title IV, §413(c)(21), Oct. 22, 2004, 118 Stat. 1509; Pub. L. 109-135, title IV, §402(a)(2), Dec. 21, 2005, 119 Stat. 2610.)

REFERENCES IN TEXT

Section 113(a)(23) of the Internal Revenue Code of 1939, referred to in par. (4), was classified to section 113(a)(23) of former Title 26, Internal Revenue Code. Section 113 was repealed by section 7851(a)(1) of this title. For table of comparisons of the 1939 Code to the 1986 Code, see Table I preceding section 1 of this title. See, also, section 7851(e) of this title for provision that references in the 1986 Code to a provision of the 1939 Code, not then applicable, shall be deemed a reference to the corresponding provision of the 1986 Code, which is then applicable.

The date of the enactment of the Taxpayer Relief Act of 1997, referred to in par. (6), is the date of enactment of Pub. L. 105-34, which was approved Aug. 5, 1997.

The Internal Revenue Code of 1939, referred to in par. (8), is act Feb. 10, 1939, ch. 2, 53 Stat. 1, as amended. Prior to the enactment of the Internal Revenue Code of 1986 [formerly I.R.C. 1954], the 1939 Code was classified to former Title 26, Internal Revenue Code. For table of comparisons of the 1939 Code to the 1986 Code, see Table I preceding section 1 of this title.

AMENDMENTS

2005—Pars. (3) to (16). Pub. L. 109-135 redesignated pars. (4) to (16) as (3) to (15), respectively, and struck out former par. (3) which read as follows: "In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain was recognized to the distributee under section 1081(c) (or under section 112(g) of the Revenue Act of 1928, 45 Stat. 818, or the Revenue Act of 1932, 48 Stat. 705), there shall be included the period for which he held the stock or securities in the distributing corporation before the receipt of the stock or securities on such distribution."

2004—Pars. (10) to (17). Pub. L. 108-357 redesignated pars. (11) to (17) as (10) to (16), respectively, and struck out former par. (10) which read as follows: "In determining the period for which the taxpayer has held trust certificates of a trust to which subsection (d) of section 1246 applies, or the period for which the taxpayer has held stock in a corporation to which subsection (d) of section 1246 applies, there shall be included the period for which the trust or corporation (as the case may be) held the stock of foreign investment companies."

2000—Par. (15). Pub. L. 106-554, §1(a)(7) [title I, §116(b)(2)], amended par. (15) generally. Prior to amendment, par. (15) read as follows: "In determining the period for which the taxpayer has held property the acquisition of which resulted under section 1045 in the nonrecognition of any part of the gain realized on the

sale of other property, there shall be included the period for which such other property has been held as of the date of such sale.”

Pars. (16), (17). Pub. L. 106-554, §1(a)(7) [title IV, §401(h)(1)], added par. (16) and redesignated former par. (16) as (17).

1998—Pars. (11), (12). Pub. L. 105-206, §6005(d)(4), substituted “18 months” for “1 year” in subpar. (B) and concluding provisions.

Pub. L. 105-206, §5001(a)(5), substituted “1 year” for “18 months” in subpar. (B) and concluding provisions.

1997—Par. (7). Pub. L. 105-34, §312(d)(9), inserted “(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)” after “section 1034”.

Pars. (15), (16). Pub. L. 105-34, §313(b)(2), added par. (15) and redesignated former par. (15) as (16).

1989—Pars. (14), (15). Pub. L. 101-194 added par. (14) and redesignated former par. (14) as (15).

1988—Par. (14). Pub. L. 100-647 amended par. (14) generally, substituting “reference” for “references” in heading, striking out “(A)” before “For special holding”, and striking out subpar. (B) which related to distributions of appreciated property to corporations.

1984—Pars. (11), (12). Pub. L. 98-369, §1001(b)(14), (e), substituted “6 months” for “1 year”, applicable to property acquired after June 22, 1984, and before Jan. 1, 1988. See Effective Date of 1984 Amendment note below.

Par. (13). Pub. L. 98-369, §541(b)(1), added par. (13). Former par. (13) redesignated (14).

Par. (14). Pub. L. 98-369, §541(b)(1), redesignated former par. (13) as (14).

Pub. L. 98-369, §54(c), designated existing cross reference as subpar. (A) and added subpar. (B).

1983—Par. (8). Pub. L. 97-448, §105(c)(4), inserted “(other than a commodity futures contract to which section 1256 applies)” after “acquired in satisfaction of a commodity futures contract”.

Pars. (12), (13). Pub. L. 97-448, §104(b)(3)(C), added par. (12) and redesignated former par. (12) as (13).

1980—Par. (11)(A). Pub. L. 96-223 repealed the amendment made by Pub. L. 95-600. See 1978 Amendment note below.

1978—Par. (11)(A). Pub. L. 95-600 inserted reference to determination of basis of property under section 1023. See Repeals note below.

1976—Par. (5). Pub. L. 94-455, §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

Par. (11). Pub. L. 94-455, §1402(b)(2), provided that “9 months” would be changed to “1 year”.

Pub. L. 94-455, §1402(b)(1)(Q), provided that “6 months” would be changed to “9 months” for taxable years beginning in 1977.

1970—Pars. (11), (12). Pub. L. 91-614 added par. (11) and redesignated former par. (11) as (12).

1962—Pars. (10), (11). Pub. L. 87-834 added par. (10) and redesignated former par. (10) as (11).

EFFECTIVE DATE OF 2005 AMENDMENT

Amendment by Pub. L. 109-135 effective as if included in the provisions of the Energy Policy Act of 2005, Pub. L. 109-58, to which it relates, but not applicable with respect to any transaction ordered in compliance with the Public Utility Holding Company Act of 1935 (15 U.S.C. 79 et seq.) before its repeal, see section 402(m) of Pub. L. 109-135, set out as an Effective and Termination Dates of 2005 Amendments note under section 23 of this title.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108-357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE DATE OF 2000 AMENDMENT

Amendment by section 1(a)(7) [title I, §116(b)(2)] of Pub. L. 106-554 applicable to qualified empowerment

zone assets acquired after Dec. 21, 2000, see section 1(a)(7) [title I, §116(c)] of Pub. L. 106-554, set out as a note under section 1016 of this title.

Amendment by section 1(a)(7) [title IV, §401(h)(1)] of Pub. L. 106-554 effective Dec. 21, 2000, see section 1(a)(7) [title IV, §401(j)] of Pub. L. 106-554, set out as a note under section 1032 of this title.

EFFECTIVE DATE OF 1998 AMENDMENT

Amendment by section 5001(a)(5) of Pub. L. 105-206 effective Jan. 1, 1998, see section 5001(b)(2) of Pub. L. 105-206, set out as a note under section 1 of this title.

Amendment by section 6005(d)(4) of Pub. L. 105-206 effective, except as otherwise provided, as if included in the provisions of the Taxpayer Relief Act of 1997, Pub. L. 105-34, to which such amendment relates, see section 6024 of Pub. L. 105-206, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by section 312(d)(9) of Pub. L. 105-34 applicable to sales and exchanges after May 6, 1997, with certain exceptions, see section 312(d) of Pub. L. 105-34, set out as a note under section 121 of this title.

Amendment by section 313(b)(2) of Pub. L. 105-34 applicable to sales after Aug. 5, 1997, see section 313(c) of Pub. L. 105-34, set out as a note under section 1016 of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101-194 applicable to sales after Nov. 30, 1989, see section 502(c) of Pub. L. 101-194, set out as a note under section 1016 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 541(b)(1) of Pub. L. 98-369 applicable to sales of securities in taxable years beginning after July 18, 1984, see section 541(c) of Pub. L. 98-369, set out as an Effective Date note under section 1042 of this title.

Amendment by section 1001(b)(14) of Pub. L. 98-369 applicable to property acquired after June 22, 1984, and before Jan. 1, 1988, see section 1001(e) of Pub. L. 98-369, set out as a note under section 166 of this title.

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by Pub. L. 97-448 effective, except as otherwise provided, as if it had been included in the provision of the Economic Recovery Tax Act of 1981, Pub. L. 97-34, to which such amendment relates, see section 109 of Pub. L. 97-448, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1980 AMENDMENT AND REVIVAL OF PRIOR LAW

Amendment by Pub. L. 96-223 (repealing section 702(c)(5) of Pub. L. 95-600 and the amendments made thereby, which had amended this section) applicable in respect of decedents dying after Dec. 31, 1976, and except for certain elections, this title to be applied and administered as if those repealed provisions had not been enacted, see section 401(b), (e) of Pub. L. 96-223, set out as a note under section 1023 of this title.

EFFECTIVE DATE OF 1978 AMENDMENT

Amendment by Pub. L. 95-600 to take effect as if included in the amendments and additions made by, and the appropriate provisions of Pub. L. 94-455, see section 702(c)(10) of Pub. L. 95-600, set out as a note under section 1014 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Section 1402(b)(1) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning in 1977.

Section 1402(b)(2) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning after Dec. 31, 1977.

EFFECTIVE DATE OF 1970 AMENDMENT

Amendment by Pub. L. 91-614 applicable with respect to decedents dying after Dec. 31, 1970, see section 101(j) of Pub. L. 91-614, set out as a note under section 2032 of this title.

EFFECTIVE DATE OF 1962 AMENDMENT

Amendment by Pub. L. 87-834 applicable with respect to taxable years beginning after Dec. 31, 1962, see section 14(c) of Pub. L. 87-834, set out as a note under section 312 of this title.

REPEALS

Pub. L. 95-600, § 702(c)(5), cited as a credit to this section, and the amendments made thereby, were repealed by Pub. L. 96-223, title IV, § 401(a), 94 Stat. 299, resulting in the text of this section reading as it read prior to enactment of section 702(c)(5). See Effective Date of 1980 Amendment and Revival of Prior Law note set out above.

PART IV—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

- Sec.
1231. Property used in the trade or business and involuntary conversions.
[1232 to 1232B. Repealed.]
1233. Gains and losses from short sales.
1234. Options to buy or sell.
1234A. Gains or losses from certain terminations.
1234B. Gains or losses from securities futures contracts.
1235. Sale or exchange of patents.
1236. Dealers in securities.
1237. Real property subdivided for sale.
[1238. Repealed.]
1239. Gain from sale of certain property between spouses or between an individual and a controlled corporation.¹
[1240. Repealed.]
1241. Cancellation of lease or distributor's agreement.
1242. Losses on small business investment company stock.
1243. Loss of small business investment company.
1244. Losses on small business stock.
1245. Gain from dispositions of certain depreciable property.
[1246, 1247. Repealed.]
1248. Gain from certain sales or exchanges of stock in certain foreign corporations.
1249. Gain from certain sales or exchanges of patents, etc., to foreign corporations.
1250. Gain from dispositions of certain depreciable realty.
[1251. Repealed.]
1252. Gain from the disposition of farm land.¹
1253. Transfers of franchises, trademarks, and trade names.
1254. Gain from disposition of interest in oil, gas, geothermal, or other mineral properties.
1255. Gain from disposition of section 126 property.
1256. Section 1256 contracts marked to market.
1257. Disposition of converted wetlands or highly erodible croplands.
1258. Recharacterization of gain from certain financial transactions.

¹ So in original. Does not conform to section catchline.

1259. Constructive sales treatment for appreciated financial positions.
1260. Gains from constructive ownership transactions.

AMENDMENTS

2004—Pub. L. 108-357, title IV, § 413(c)(32), Oct. 22, 2004, 118 Stat. 1510, struck out items 1246 “Gain on foreign investment company stock” and 1247 “Election by foreign investment companies to distribute income currently”.

Pub. L. 108-311, title IV, § 408(a)(18), Oct. 4, 2004, 118 Stat. 1192, substituted “Gains or losses from securities futures contracts” for “Securities futures contracts” in item 1234B.

2000—Pub. L. 106-554, § 1(a)(7) [title IV, § 401(h)(2)], Dec. 21, 2000, 114 Stat. 2763, 2763A-650, which directed the amendment of the table of sections of subpart IV of subchapter P of chapter 1 by adding item 1234B, was executed by adding item 1234B to the table of sections for this part which is part IV of subchapter P of chapter 1 to reflect the probable intent of Congress.

1999—Pub. L. 106-170, title V, § 534(b), Dec. 17, 1999, 113 Stat. 1934, added item 1260.

1997—Pub. L. 105-34, title X, § 1001(c), Aug. 5, 1997, 111 Stat. 907, added item 1259.

1993—Pub. L. 103-66, title XIII, § 13206(a)(2), Aug. 10, 1993, 107 Stat. 465, added item 1258.

1990—Pub. L. 101-508, title XI, § 11801(b)(10), Nov. 5, 1990, 104 Stat. 1388-522, struck out item 1238 “Amortization in excess of depreciation”.

1988—Pub. L. 100-647, title I, § 1018(u)(24), Nov. 10, 1988, 102 Stat. 3591, substituted “geothermal, or other mineral properties” for “or geothermal property” in item 1254.

1986—Pub. L. 99-514, title IV, § 403(b), Oct. 22, 1986, 100 Stat. 2222, added item 1257.

1984—Pub. L. 98-369, div. A, title I, §§ 42(b)(2), 102(e)(6), title IV, § 492(c), July 18, 1984, 98 Stat. 557, 624, 854, struck out items 1232 “Bonds and other evidence of indebtedness”, 1232A “Original issue discount”, 1232B “Tax treatment of stripped bonds”, 1251 “Gain from disposition of property used in farming where farm losses offset nonfarm income”, and substituted “Section 1256 contracts” for “Regulated futures contracts” in item 1256.

1982—Pub. L. 97-248, title II, §§ 231(d), 232(c), Sept. 3, 1982, 96 Stat. 499, 501, added items 1232A and 1232B.

1981—Pub. L. 97-34, title V, §§ 503(b), 507(b), Aug. 13, 1981, 95 Stat. 330, 333, added items 1234A and 1256.

1978—Pub. L. 95-618, title IV, § 402(c)(4), Nov. 9, 1978, 92 Stat. 3202, substituted “oil, gas, or geothermal” for “oil or gas” in item 1254.

Pub. L. 95-600, title V, § 543(c)(2), Nov. 6, 1978, 92 Stat. 2890, added item 1255.

1976—Pub. L. 94-455, title II, § 205(d), title XIX, § 1901(b)(34), Oct. 4, 1976, 90 Stat. 1535, 1802, added item 1254 and struck out item 1240 “Taxability to employee of termination payments”.

1969—Pub. L. 91-172, title II, §§ 211(b)(7), 214(b), title V, § 516(c)(2)(C), Dec. 30, 1969, 83 Stat. 570, 573, 648, added items 1251 to 1253.

1964—Pub. L. 88-272, title II, § 231(b)(7), Feb. 26, 1964, 78 Stat. 105, added item 1250.

1962—Pub. L. 87-834, §§ 13(a)(2), 14(a)(2), 15(b), 16(b), Oct. 16, 1962, 76 Stat. 1033, 1040, 1044, 1045, added items 1245-1249.

1958—Pub. L. 85-866, title I, § 57(c)(3), title II, § 202(c), Sept. 2, 1958, 72 Stat. 1646, 1678, added items 1242-1244.

§ 1231. Property used in the trade or business and involuntary conversions

(a) General rule

(1) Gains exceed losses

If—

(A) the section 1231 gains for any taxable year, exceed

(B) the section 1231 losses for such taxable year,

such gains and losses shall be treated as long-term capital gains or long-term capital losses, as the case may be.

(2) Gains do not exceed losses

If—

(A) the section 1231 gains for any taxable year, do not exceed

(B) the section 1231 losses for such taxable year,

such gains and losses shall not be treated as gains and losses from sales or exchanges of capital assets.

(3) Section 1231 gains and losses

For purposes of this subsection—

(A) Section 1231 gain

The term “section 1231 gain” means—

(i) any recognized gain on the sale or exchange of property used in the trade or business, and

(ii) any recognized gain from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) into other property or money of—

(I) property used in the trade or business, or

(II) any capital asset which is held for more than 1 year and is held in connection with a trade or business or a transaction entered into for profit.

(B) Section 1231 loss

The term “section 1231 loss” means any recognized loss from a sale or exchange or conversion described in subparagraph (A).

(4) Special rules

For purposes of this subsection—

(A) In determining under this subsection whether gains exceed losses—

(i) the section 1231 gains shall be included only if and to the extent taken into account in computing gross income, and

(ii) the section 1231 losses shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply.

(B) Losses (including losses not compensated for by insurance or otherwise) on the destruction, in whole or in part, theft or seizure, or requisition or condemnation of—

(i) property used in the trade or business, or

(ii) capital assets which are held for more than 1 year and are held in connection with a trade or business or a transaction entered into for profit,

shall be treated as losses from a compulsory or involuntary conversion.

(C) In the case of any involuntary conversion (subject to the provisions of this subsection but for this sentence) arising from fire, storm, shipwreck, or other casualty, or from theft, of any—

(i) property used in the trade or business, or

(ii) any capital asset which is held for more than 1 year and is held in connection with a trade or business or a transaction entered into for profit,

this subsection shall not apply to such conversion (whether resulting in gain or loss) if during the taxable year the recognized losses from such conversions exceed the recognized gains from such conversions.

(b) Definition of property used in the trade or business

For purposes of this section—

(1) General rule

The term “property used in the trade or business” means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 1 year, and real property used in the trade or business, held for more than 1 year, which is not—

(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year,

(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business,

(C) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by a taxpayer described in paragraph (3) of section 1221(a), or

(D) a publication of the United States Government (including the Congressional Record) which is received from the United States Government, or any agency thereof, other than by purchase at the price at which it is offered for sale to the public, and which is held by a taxpayer described in paragraph (5) of section 1221(a).

(2) Timber, coal, or domestic iron ore

Such term includes timber, coal, and iron ore with respect to which section 631 applies.

(3) Livestock

Such term includes—

(A) cattle and horses, regardless of age, held by the taxpayer for draft, breeding, dairy, or sporting purposes, and held by him for 24 months or more from the date of acquisition, and

(B) other livestock, regardless of age, held by the taxpayer for draft, breeding, dairy, or sporting purposes, and held by him for 12 months or more from the date of acquisition.

Such term does not include poultry.

(4) Unharvested crop

In the case of an unharvested crop on land used in the trade or business and held for more than 1 year, if the crop and the land are sold or exchanged (or compulsorily or involuntarily converted) at the same time and to the same person, the crop shall be considered as “property used in the trade or business.”

(c) Recapture of net ordinary losses**(1) In general**

The net section 1231 gain for any taxable year shall be treated as ordinary income to the extent such gain does not exceed the non-recaptured net section 1231 losses.

(2) Non-recaptured net section 1231 losses

For purposes of this subsection, the term “non-recaptured net section 1231 losses” means the excess of—

(A) the aggregate amount of the net section 1231 losses for the 5 most recent preceding taxable years beginning after December 31, 1981, over

(B) the portion of such losses taken into account under paragraph (1) for such preceding taxable years.

(3) Net section 1231 gain

For purposes of this subsection, the term “net section 1231 gain” means the excess of—

(A) the section 1231 gains, over

(B) the section 1231 losses.

(4) Net section 1231 loss

For purposes of this subsection, the term “net section 1231 loss” means the excess of—

(A) the section 1231 losses, over

(B) the section 1231 gains.

(5) Special rules

For purposes of determining the amount of the net section 1231 gain or loss for any taxable year, the rules of paragraph (4) of subsection (a) shall apply.

(Aug. 16, 1954, ch. 736, 68A Stat. 325; Pub. L. 85-866, title I, § 49(a), Sept. 2, 1958, 72 Stat. 1642; Pub. L. 88-272, title II, § 227(a)(2), Feb. 26, 1964, 78 Stat. 97; Pub. L. 91-172, title II, § 212(b)(1), title V, § 514(b)(2), 516(b), Dec. 30, 1969, 83 Stat. 571, 643, 646; Pub. L. 94-455, title XIV, § 1402(b)(1)(R), (2), Oct. 4, 1976, 90 Stat. 1732; Pub. L. 95-600, title VII, § 701(ee)(1), Nov. 6, 1978, 92 Stat. 2924; Pub. L. 97-34, title V, § 505(c)(1), Aug. 13, 1981, 95 Stat. 332; Pub. L. 98-369, div. A, title I, § 176(a), title VII, § 711(c)(2)(A)(iii), title X, § 1001(b)(15), (e), July 18, 1984, 98 Stat. 709, 944, 1012; Pub. L. 106-170, title V, § 532(c)(1)(G), Dec. 17, 1999, 113 Stat. 1930.)

AMENDMENTS

1999—Subsec. (b)(1)(C), (D). Pub. L. 106-170 substituted “section 1221(a)” for “section 1221”.

1984—Subsec. (a). Pub. L. 98-369, § 1001(b)(15), (e), substituted “6 months” for “1 year” wherever appearing, applicable to property acquired after June 22, 1984, and before Jan. 1, 1988. See Effective Date of 1984 Amendment note below.

Pub. L. 98-369, § 711(c)(2)(A)(iii), amended subsec. (a) generally, substituting pars. (1) to (4), for “If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 1 year into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 1 year. If such gains do not exceed such losses, such gains

and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection—

“(1) in determining under this subsection whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply; and

“(2) losses (including losses not compensated for by insurance or otherwise) upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of (A) property used in the trade or business or (B) capital assets held for more than 1 year shall be considered losses from a compulsory or involuntary conversion.

In the case of any involuntary conversion (subject to the provisions of this subsection but for this sentence) arising from fire, storm, shipwreck, or other casualty, or from theft, of any property used in the trade or business or of any capital asset held for more than 1 year, this subsection shall not apply to such conversion (whether resulting in gain or loss) if during the taxable year the recognized losses from such conversions exceed the recognized gains from such conversions.”

Subsec. (b)(1), (4). Pub. L. 98-369, § 1001(b)(15), (e), substituted “6 months” for “1 year”, applicable to property acquired after June 22, 1984, and before Jan. 1, 1988. See Effective Date of 1984 Amendment note below.

Subsec. (c). Pub. L. 98-369, § 176(a), added subsec. (c). 1981—Subsec. (b)(1)(D). Pub. L. 97-34 substituted “paragraph (5)” for “paragraph (6)”.

1978—Subsec. (b)(1)(D). Pub. L. 95-600 added subpar. (D).

1976—Subsecs. (a), (b)(1), (4). Pub. L. 94-455, § 1402(b)(2), provided that “9 months” would be changed to “1 year” wherever appearing.

Pub. L. 94-455, § 1402(b)(1)(R), provided that in subsecs. (a), first and last sentences, (a)(2), and (b)(1), (4), “6 months” would be changed to “9 months” for taxable years beginning in 1977.

1969—Subsec. (a). Pub. L. 91-172, § 516(b), provided that casualty (or theft) losses with respect to depreciable property and real estate used in trade or business and capital assets held for the production of income as well as personal assets are to be consolidated with casualty (or theft) gains with respect to this type of property and if the casualty losses exceed the casualty gains, the net loss is treated as an ordinary loss without regard to whether there may be noncasualty gains under this section, but, if the casualty gains exceed the casualty losses, the net gain is treated as a gain under this section and must be consolidated with other gains and losses under this section.

Subsec. (b)(1)(C). Pub. L. 91-172, § 514(b)(2), inserted reference to a letter or memorandum.

Subsec. (b)(3). Pub. L. 91-172, § 212(b)(1), redesignated existing provisions as subpar. (B) and added subpar. (A).

1964—Subsec. (b)(2). Pub. L. 88-272 inserted reference to iron ore in text, and to domestic iron ore in heading.

1958—Subsec. (a). Pub. L. 85-866 inserted provision respecting casualty losses sustained upon certain uninsured property.

EFFECTIVE DATE OF 1999 AMENDMENT

Amendment by Pub. L. 106-170 applicable to any instrument held, acquired, or entered into, any transaction entered into, and supplies held or acquired on or after Dec. 17, 1999, see section 532(d) of Pub. L. 106-170, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Section 176(b) of Pub. L. 98-369 provided that: “The amendment made by subsection (a) [amending this section] shall apply to net section 1231 gains for taxable years beginning after December 31, 1984.”

Amendment by section 711(c)(2)(A)(iii) of Pub. L. 98-369 applicable to taxable years beginning after Dec.

31, 1983, see section 711(c)(2)(A)(v) of Pub. L. 98-369, set out as a note under section 165 of this title.

Amendment by section 1001(b)(15) of Pub. L. 98-369 applicable to property acquired after June 22, 1984, and before Jan. 1, 1988, see section 1001(e) of Pub. L. 98-369, set out as a note under section 166 of this title.

EFFECTIVE DATE OF 1981 AMENDMENT

Amendment by Pub. L. 97-34 applicable to property acquired and positions established by the taxpayer after June 23, 1981, in taxable years ending after such date, and applicable when so elected with respect to property held on June 23, 1981, see section 508 of Pub. L. 97-34, set out as an Effective Date note under section 1092 of this title.

EFFECTIVE DATE OF 1978 AMENDMENT

Section 701(ee)(2) of Pub. L. 95-600 provided that: "The amendment made by paragraph (1) [amending this section] shall apply with respect to sales, exchanges, and contributions made after October 4, 1976."

EFFECTIVE DATE OF 1976 AMENDMENT

Section 1402(b)(1) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning in 1977.

Section 1402(b)(2) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning after Dec. 31, 1977.

EFFECTIVE DATE OF 1969 AMENDMENT

Section 212(b)(2) of Pub. L. 91-172 provided that: "The amendments made by paragraph (1) [amending this section] shall apply to livestock acquired after December 31, 1969."

Amendment by section 514(b)(2) of Pub. L. 91-172 applicable to sales and other dispositions occurring after July 25, 1969, see section 514(c) of Pub. L. 91-172, set out as a note under section 1221 of this title.

Amendment by section 516(b) of Pub. L. 91-172 applicable to taxable years beginning after Dec. 31, 1969, see section 516(d)(2) of Pub. L. 91-172, set out as a note under section 1001 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment by Pub. L. 88-272 applicable with respect to amounts received or accrued in taxable years beginning after Dec. 31, 1963, attributable to iron ore mined in such years, see section 227(c) of Pub. L. 88-272, set out as a note under section 272 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 49(b) of Pub. L. 85-866 provided that: "The amendment made by subsection (a) [amending this section] shall apply to taxable years beginning after December 31, 1957."

[[§ 1232 to 1232B. Repealed. Pub. L. 98-369, div. A, title I, § 42(a)(1), July 18, 1984, 98 Stat. 556]

Section 1232, acts Aug. 16, 1954, ch. 736, 68A Stat. 326; Sept. 2, 1958, Pub. L. 85-866, title I, §§ 50(a), 51, 72 Stat. 1642, 1643; June 25, 1959, Pub. L. 86-69, § 3(e), 73 Stat. 140; Sept. 2, 1964, Pub. L. 88-563, § 5, 78 Stat. 845; Dec. 30, 1969, Pub. L. 91-172, title IV, § 413(a), (b), 83 Stat. 609, 611; Oct. 4, 1976, Pub. L. 94-455, title XIV, § 1402(b)(1)(S), (2), title XIX, §§ 1901(b)(3)(I), (14)(D), 1904(b)(10)(C), 90 Stat. 1732, 1793, 1796, 1817; Aug. 13, 1981, Pub. L. 97-34, title V, § 505(b), 95 Stat. 331; Sept. 3, 1982, Pub. L. 97-248, title II, §§ 231(c), 232(b), title III, § 310(b)(6), 96 Stat. 499, 501, 599; Jan. 12, 1983, Pub. L. 97-448, title III, § 306(a)(9)(B), (C)(i), (ii), 96 Stat. 2403, 2404; July 18, 1984, Pub. L. 98-369, div. A, title X, § 1001(b)(16), (d), (e), 98 Stat. 1012, related to bonds and other evidences of indebtedness. See section 1271 et seq. of this title.

Section 1232A, added Pub. L. 97-248, title II, § 231(a), Sept. 3, 1982, 96 Stat. 496; amended Pub. L. 98-369, div. A, title II, § 211(b)(17), July 18, 1984, 98 Stat. 756, related

to original issue discount. See section 1271 et seq. of this title.

Section 1232B, added Pub. L. 97-248, title II, § 232(a), Sept. 3, 1982, 96 Stat. 499, related to stripped bonds. See section 1286 of this title.

EFFECTIVE DATE OF REPEAL

Repeal applicable to taxable years ending after July 18, 1984, see section 44 of Pub. L. 98-369, set out as an Effective Date note under section 1271 of this title.

§ 1233. Gains and losses from short sales

(a) Capital assets

For purposes of this subtitle, gain or loss from the short sale of property shall be considered as gain or loss from the sale or exchange of a capital asset to the extent that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of the taxpayer.

(b) Short-term gains and holding periods

If gain or loss from a short sale is considered as gain or loss from the sale or exchange of a capital asset under subsection (a) and if on the date of such short sale substantially identical property has been held by the taxpayer for not more than 1 year (determined without regard to the effect, under paragraph (2) of this subsection, of such short sale on the holding period), or if substantially identical property is acquired by the taxpayer after such short sale and on or before the date of the closing thereof—

(1) any gain on the closing of such short sale shall be considered as a gain on the sale or exchange of a capital asset held for not more than 1 year (notwithstanding the period of time any property used to close such short sale has been held); and

(2) the holding period of such substantially identical property shall be considered to begin (notwithstanding section 1223, relating to the holding period of property) on the date of the closing of the short sale, or on the date of a sale, gift, or other disposition of such property, whichever date occurs first. This paragraph shall apply to such substantially identical property in the order of the dates of the acquisition of such property, but only to so much of such property as does not exceed the quantity sold short.

For purposes of this subsection, the acquisition of an option to sell property at a fixed price shall be considered as a short sale, and the exercise or failure to exercise such option shall be considered as a closing of such short sale.

(c) Certain options to sell

Subsection (b) shall not include an option to sell property at a fixed price acquired on the same day on which the property identified as intended to be used in exercising such option is acquired and which, if exercised, is exercised through the sale of the property so identified. If the option is not exercised, the cost of the option shall be added to the basis of the property with which the option is identified. This subsection shall apply only to options acquired after August 16, 1954.

(d) Long-term losses

If on the date of such short sale substantially identical property has been held by the taxpayer

for more than 1 year, any loss on the closing of such short sale shall be considered as a loss on the sale or exchange of a capital asset held for more than 1 year (notwithstanding the period of time any property used to close such short sale has been held, and notwithstanding section 1234).

(e) Rules for application of section

(1) Subsection (b)(1) or (d) shall not apply to the gain or loss, respectively, on any quantity of property used to close such short sale which is in excess of the quantity of the substantially identical property referred to in the applicable subsection.

(2) For purposes of subsections (b) and (d)—

(A) the term “property” includes only stocks and securities (including stocks and securities dealt with on a “when issued” basis), and commodity futures, which are capital assets in the hands of the taxpayer, but does not include any position to which section 1092(b) applies;

(B) in the case of futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange, a commodity future requiring delivery in 1 calendar month shall not be considered as property substantially identical to another commodity future requiring delivery in a different calendar month;

(C) in the case of a short sale of property by an individual, the term “taxpayer”, in the application of this subsection and subsections (b) and (d), shall be read as “taxpayer or his spouse”; but an individual who is legally separated from the taxpayer under a decree of divorce or of separate maintenance shall not be considered as the spouse of the taxpayer;

(D) a securities futures contract (as defined in section 1234B) to acquire substantially identical property shall be treated as substantially identical property; and

(E) entering into a securities futures contract (as so defined) to sell shall be considered to be a short sale, and the settlement of such contract shall be considered to be the closing of such short sale.

(3) Where the taxpayer enters into 2 commodity futures transactions on the same day, one requiring delivery by him in one market and the other requiring delivery to him of the same (or substantially identical) commodity in the same calendar month in a different market, and the taxpayer subsequently closes both such transactions on the same day, subsections (b) and (d) shall have no application to so much of the commodity involved in either such transaction as does not exceed in quantity the commodity involved in the other.

(4)(A) In the case of a taxpayer who is a dealer in securities (within the meaning of section 1236)—

(i) if, on the date of a short sale of stock, substantially identical property which is a capital asset in the hands of the taxpayer has been held for not more than 1 year, and

(ii) if such short sale is closed more than 20 days after the date on which it was made,

subsection (b)(2) shall apply in respect of the holding period of such substantially identical property.

(B) For purposes of subparagraph (A)—

(i) the last sentence of subsection (b) applies; and

(ii) the term “stock” means any share or certificate of stock in a corporation, any bond or other evidence of indebtedness which is convertible into any such share or certificate, or any evidence of an interest in, or right to subscribe to or purchase, any of the foregoing.

(f) Arbitrage operations in securities

In the case of a short sale which had been entered into as an arbitrage operation, to which sale the rule of subsection (b)(2) would apply except as otherwise provided in this subsection—

(1) subsection (b)(2) shall apply first to substantially identical assets acquired for arbitrage operations held at the close of business on the day such sale is made, and only to the extent that the quantity sold short exceeds the substantially identical assets acquired for arbitrage operations held at the close of business on the day such sale is made, shall the holding period of any other such identical assets held by the taxpayer be affected;

(2) in the event that assets acquired for arbitrage operations are disposed of in such manner as to create a net short position in assets acquired for arbitrage operations, such net short position shall be deemed to constitute a short sale made on that day;

(3) for the purpose of paragraphs (1) and (2) of this subsection the taxpayer will be deemed as of the close of any business day to hold property which he is or will be entitled to receive or acquire by virtue of any other asset acquired for arbitrage operations or by virtue of any contract he has entered into in an arbitrage operation; and

(4) for the purpose of this subsection arbitrage operations are transactions involving the purchase and sale of assets for the purpose of profiting from a current difference between the price of the asset purchased and the price of the asset sold, and in which the asset purchased, if not identical to the asset sold, is such that by virtue thereof the taxpayer is, or will be, entitled to acquire assets identical to the assets sold. Such operations must be clearly identified by the taxpayer in his records as arbitrage operations on the day of the transaction or as soon thereafter as may be practicable. Assets acquired for arbitrage operations will include stocks and securities and the right to acquire stocks and securities.

(g) Hedging transactions

This section shall not apply in the case of a hedging transaction in commodity futures.

(h) Short sales of property which becomes substantially worthless

(1) In general

If—

(A) the taxpayer enters into a short sale of property, and

(B) such property becomes substantially worthless,

the taxpayer shall recognize gain in the same manner as if the short sale were closed when the property becomes substantially worthless.

To the extent provided in regulations prescribed by the Secretary, the preceding sentence also shall apply with respect to any option with respect to property, any offsetting notional principal contract with respect to property, any futures or forward contract to deliver any property, and any other similar transaction.

(2) Statute of limitations

If property becomes substantially worthless during a taxable year and any short sale of such property remains open at the time such property becomes substantially worthless, then—

(A) the statutory period for the assessment of any deficiency attributable to any part of the gain on such transaction shall not expire before the earlier of—

(i) the date which is 3 years after the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) of the substantial worthlessness of such property, or

(ii) the date which is 6 years after the date the return for such taxable year is filed, and

(B) such deficiency may be assessed before the date applicable under subparagraph (A) notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

(Aug. 16, 1954, ch. 736, 68A Stat. 327; Aug. 12, 1955, ch. 871, § 1, 69 Stat. 717; Pub. L. 85-866, title I, § 52(a), (b), Sept. 2, 1958, 72 Stat. 1643, 1644; Pub. L. 94-455, title XIV, § 1402(b)(1)(T), (2), title XIX, § 1901(a)(137), Oct. 4, 1976, 90 Stat. 1732, 1787; Pub. L. 97-34, title V, § 501(c), Aug. 13, 1981, 95 Stat. 326; Pub. L. 98-369, div. A, title X, § 1001(b)(17), (e), July 18, 1984, 98 Stat. 1012; Pub. L. 105-34, title X, § 1003(b)(1), Aug. 5, 1997, 111 Stat. 910; Pub. L. 106-554, § 1(a)(7) [title IV, § 401(f)], Dec. 21, 2000, 114 Stat. 2763, 2763A-649; Pub. L. 107-147, title IV, § 412(d)(3)(A), Mar. 9, 2002, 116 Stat. 54.)

AMENDMENTS

2002—Subsec. (e)(2)(E). Pub. L. 107-147 added subpar. (E).

2000—Subsec. (e)(2)(D). Pub. L. 106-554 added subpar. (D).

1997—Subsec. (h). Pub. L. 105-34 added subsec. (h).

1984—Subsecs. (b), (d), (e)(4)(A)(i). Pub. L. 98-369 substituted “6 months” for “1 year” wherever appearing, applicable to property acquired after June 22, 1984, and before Jan. 1, 1988. See Effective Date of 1984 Amendment note below.

1981—Subsec. (e)(2)(A). Pub. L. 97-34 inserted “, but does not include any position to which section 1092(b) applies” after “taxpayer”.

1976—Subsec. (b). Pub. L. 94-455, § 1402(b)(2), provided that “9 months” would be changed to “1 year”.

Pub. L. 94-455, § 1402(b)(1)(T), (2), provided that “6 months” would be changed to “9 months” for taxable years beginning in 1977.

Subsec. (c). Pub. L. 94-455, § 1901(a)(137), substituted “August 16, 1954” for “the date of enactment of this title”.

Subsecs. (d), (e)(4)(A)(i). Pub. L. 94-455, § 1402(b)(2), provided that “9 months” would be changed to “1 year”.

Pub. L. 94-455, § 1402(b)(1)(T), provided that “6 months” would be changed to “9 months” for taxable years beginning in 1977.

1958—Subsec. (a). Pub. L. 85-866, § 52(b), struck out “, other than a hedging transaction in commodity futures,” after “sale of property”.

Subsec. (e)(4). Pub. L. 85-866, § 52(a), added par. (4).

Subsec. (g). Pub. L. 85-866, § 52(b), added subsec. (g).

1955—Subsec. (f). Act Aug. 12, 1955, added subsec. (f).

EFFECTIVE DATE OF 2002 AMENDMENT

Amendment by Pub. L. 107-147 effective as if included in the provisions of the Community Renewal Tax Relief Act of 2000 [H.R. 5662, as enacted by Pub. L. 106-554], to which such amendment relates, see section 412(e) of Pub. L. 107-147, set out as a note under section 151 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Section 1003(b)(2) of Pub. L. 105-34 provided that: “The amendment made by paragraph (1) [amending this section] shall apply to property which becomes substantially worthless after the date of the enactment of this Act [Aug. 5, 1997].”

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 applicable to property acquired after June 22, 1984, and before Jan. 1, 1988, see section 1001(e) of Pub. L. 98-369, set out as a note under section 166 of this title.

EFFECTIVE DATE OF 1981 AMENDMENT

Amendment by Pub. L. 97-34 applicable to property acquired and positions established by the taxpayer after June 23, 1981, in taxable years ending after such date, and applicable when so elected with respect to property held on June 23, 1981, see section 508 of Pub. L. 97-34, set out as an Effective Date note under section 1092 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Section 1402(b)(1) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning in 1977.

Section 1402(b)(2) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning after Dec. 31, 1977.

Amendment by section 1901(a)(137) of Pub. L. 94-455 applicable with respect to taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment by section 52(b) of Pub. L. 85-866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1(c)(1) of Pub. L. 85-866, set out as a note under section 165 of this title.

Section 52(c) of Pub. L. 85-866 provided that: “The amendment made by subsection (a) [amending this section] shall apply with respect to short sales made after December 31, 1957.”

EFFECTIVE DATE OF 1955 AMENDMENT

Section 2 of act Aug. 12, 1955, provided that: “The amendment made by the first section of this Act [amending this section] shall apply only with respect to taxable years ending after the date of the enactment of this Act [Aug. 12, 1955] and only in the case of a short sale of property made by the taxpayer after such date.”

§ 1234. Options to buy or sell

(a) Treatment of gain or loss in the case of the purchaser

(1) General rule

Gain or loss attributable to the sale or exchange of, or loss attributable to failure to exercise, an option to buy or sell property shall be considered gain or loss from the sale or exchange of property which has the same char-

acter as the property to which the option relates has in the hands of the taxpayer (or would have in the hands of the taxpayer if acquired by him).

(2) Special rule for loss attributable to failure to exercise option

For purposes of paragraph (1), if loss is attributable to failure to exercise an option, the option shall be deemed to have been sold or exchanged on the day it expired.

(3) Nonapplication of subsection

This subsection shall not apply to—

(A) an option which constitutes property described in paragraph (1) of section 1221(a);

(B) in the case of gain attributable to the sale or exchange of an option, any income derived in connection with such option which, without regard to this subsection, is treated as other than gain from the sale or exchange of a capital asset; and

(C) a loss attributable to failure to exercise an option described in section 1233(c).

(b) Treatment of grantor of option in the case of stock, securities, or commodities

(1) General rule

In the case of the grantor of the option, gain or loss from any closing transaction with respect to, and gain on lapse of, an option in property shall be treated as a gain or loss from the sale or exchange of a capital asset held not more than 1 year.

(2) Definitions

For purposes of this subsection—

(A) Closing transaction

The term “closing transaction” means any termination of the taxpayer’s obligation under an option in property other than through the exercise or lapse of the option.

(B) Property

The term “property” means stocks and securities (including stocks and securities dealt with on a “when issued” basis), commodities, and commodity futures.

(3) Nonapplication of subsection

This subsection shall not apply to any option granted in the ordinary course of the taxpayer’s trade or business of granting options.

(c) Treatment of options on section 1256 contracts and cash settlement options

(1) Section 1256 contracts

Gain or loss shall be recognized on the exercise of an option on a section 1256 contract (within the meaning of section 1256(b)).

(2) Treatment of cash settlement options

(A) In general

For purposes of subsections (a) and (b), a cash settlement option shall be treated as an option to buy or sell property.

(B) Cash settlement option

For purposes of subparagraph (A), the term “cash settlement option” means any option which on exercise settles in (or could be settled in) cash or property other than the underlying property.

(Aug. 16, 1954, ch. 376, 68A Stat. 329; Pub. L. 85-866, title I, § 53, Sept. 2, 1958, 72 Stat. 1644; Pub. L. 89-809, title II, § 210(a), Nov. 13, 1966, 80 Stat. 1580; Pub. L. 94-455, title XIV, § 1402(b)(1)(U), (2), title XXI, § 2136(a), Oct. 4, 1976, 90 Stat. 1732, 1929; Pub. L. 98-369, div. A, title I, § 105(a), title X, § 1001(b)(18), (e), July 18, 1984, 98 Stat. 629, 1012; Pub. L. 106-170, title V, § 532(c)(1)(H), Dec. 17, 1999, 113 Stat. 1930.)

AMENDMENTS

1999—Subsec. (a)(3)(A). Pub. L. 106-170 substituted “section 1221(a)” for “section 1221”.

1984—Subsec. (b)(1). Pub. L. 98-369, § 1001(b)(18), (e), substituted “6 months” for “1 year”, applicable to property acquired after June 22, 1984, and before Jan. 1, 1988. See Effective Date of 1984 Amendment note below.

Subsec. (c). Pub. L. 98-369, § 105(a), added subsec. (c).

1976—Subsec. (a). Pub. L. 94-455, § 2136(a), inserted in heading “in the case of the purchaser”; designated existing provisions as par. “(1) General rule” and substituted “an option” and “the option” for “a privilege or option” and “the option or privilege”; redesignated existing subsec. (b) as par. (2) and substituted “an option” and “the option” for “a privilege or option” and “the privilege or option”; and redesignated existing subsec. (d)(1) to (3) as par. (3)(A) to (C) and substituted in heading and introductory text “Nonapplication” and “subsection” for “Non-application” and “section”, in par. (3)(A) “an option” for “a privilege or option”, in par. (3)(B) “an option”, “such option” and “subsection” for “a privilege or option”, “such privilege or option” and “section” and in par. (3)(C) substituted a period for “; or”.

Subsec. (b). Pub. L. 94-455, § 2136(a), added subsec. (b), incorporating provisions of a prior subsec. (c) providing for a special rule for grantors of straddles, par. (1) relating to “gain on lapse” and reading “In the case of gain on lapse of an option granted by the taxpayer as part of a straddle, the gain shall be deemed to be gain from the sale or exchange of a capital asset held for not more than 6 months on the day that the option expired.”; par. (2) relating to “exception” and reading “This subsection shall not apply to any person who holds securities for sale to customers in the ordinary course of his trade or business.”, now covered in subsec. (b)(3); and par. (3) relating to definitions of “straddle” and “security”.

Subsec. (b)(1). Pub. L. 94-455, § 1402(b)(2), provided that “9 months” would be changed to “1 year”.

Pub. L. 94-455, § 1402(b)(1)(U), provided that “6 months” would be changed to “9 months” for taxable years beginning in 1977.

Subsec. (c). Pub. L. 94-455, § 2136(a), struck out provision respecting special rule for grantors of straddles, the paragraphs relating to: (1) gain on lapse; (2) exception, now covered in subsec. (b)(3); and (3) definitions of “straddle” and “security”, such provision now covered generally by subsec. (b) of this section.

Subsec. (d). Pub. L. 94-455, § 2136(a), struck out provision respecting non-application of section, pars. (1) to (3) now covered in subsec. (a)(3)(A) to (C) of this section, and par. (4) providing for such non-application to gain attributable to the sale or exchange of a privilege or option acquired by the taxpayer before Mar. 1, 1954, if in the hands of the taxpayer such privilege or option was a capital asset.

1966—Subsecs. (c), (d). Pub. L. 89-809 added subsec. (c) and redesignated former subsec. (c) as (d).

1958—Pub. L. 85-866 amended section generally and among other changes provided in subsec. (a) that gain or loss resulting from option to buy or sell property is to be considered gain or loss arising from property which has the same character as the property underlying the option, incorporated existing provisions in subsecs. (b) and (c)(3), and inserted provisions set out in subsec. (c)(1), (2), (4).

EFFECTIVE DATE OF 1999 AMENDMENT

Amendment by Pub. L. 106-170 applicable to any instrument held, acquired, or entered into, any transaction entered into, and supplies held or acquired on or after Dec. 17, 1999, see section 532(d) of Pub. L. 106-170, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Section 105(b) of Pub. L. 98-369 provided that: “The amendment made by subsection (a) [amending this section] shall apply to options purchased or granted after October 31, 1983, in taxable years ending after such date.”

Amendment by section 1001(b)(18) of Pub. L. 98-369 applicable to property acquired after June 22, 1984, and before Jan. 1, 1988, see section 1001(e) of Pub. L. 98-369, set out as a note under section 166 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Section 1402(b)(1) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning in 1977.

Section 1402(b)(2) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning after Dec. 31, 1977.

Section 2136(b) of Pub. L. 94-455 provided that: “The amendment made by subsection (a) [amending this section] shall apply to options granted after September 1, 1976.”

EFFECTIVE DATE OF 1966 AMENDMENT

Section 210(b) of Pub. L. 89-809 provided that: “The amendments made by subsection (a) [amending this section] shall apply to straddle transactions entered into after January 25, 1965, in taxable years ending after such date.”

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment by Pub. L. 85-866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1(c)(1) of Pub. L. 85-866, set out as a note under section 165 of this title.

§ 1234A. Gains or losses from certain terminations

Gain or loss attributable to the cancellation, lapse, expiration, or other termination of—

(1) a right or obligation (other than a securities futures contract, as defined in section 1234B) with respect to property which is (or on acquisition would be) a capital asset in the hands of the taxpayer, or

(2) a section 1256 contract (as defined in section 1256) not described in paragraph (1) which is a capital asset in the hands of the taxpayer,

shall be treated as gain or loss from the sale of a capital asset. The preceding sentence shall not apply to the retirement of any debt instrument (whether or not through a trust or other participation arrangement).

(Added Pub. L. 97-34, title V, § 507(a), Aug. 13, 1981, 95 Stat. 333; amended Pub. L. 97-448, title I, § 105(e), Jan. 12, 1983, 96 Stat. 2387; Pub. L. 98-369, div. A, title I, § 102(e)(4), (9), July 18, 1984, 98 Stat. 624, 625; Pub. L. 105-34, title X, § 1003(a)(1), Aug. 5, 1997, 111 Stat. 909; Pub. L. 106-554, § 1(a)(7) [title IV, § 401(b)], Dec. 21, 2000, 114 Stat. 2763, 2763A-648; Pub. L. 107-147, title IV, § 412(d)(1)(A), Mar. 9, 2002, 116 Stat. 53.)

AMENDMENTS

2002—Pars. (1) to (3). Pub. L. 107-147 inserted “or” at end of par. (1), struck out “or” at end of par. (2), and

struck out par. (3) which read as follows: “a securities futures contract (as so defined) which is a capital asset in the hands of the taxpayer.”

2000—Par. (1). Pub. L. 106-554, § 1(a)(7) [title IV, § 401(b)(1)], inserted “(other than a securities futures contract, as defined in section 1234B)” after “right or obligation”.

Par. (3). Pub. L. 106-554, § 1(a)(7) [title IV, § 401(b)(2)-(4)], added par. (3).

1997—Par. (1). Pub. L. 105-34 substituted “property” for “personal property (as defined in section 1092(d)(1))”.

1984—Pub. L. 98-369, § 102(e)(9), inserted at end “The preceding sentence shall not apply to the retirement of any debt instrument (whether or not through a trust or other participation arrangement).”

Par. (2). Pub. L. 98-369, § 102(e)(4), substituted “a section 1256 contract” for “a regulated futures contract”.

1983—Pub. L. 97-448 inserted reference to a regulated futures contract (as defined in section 1256) not described in paragraph (1) which is a capital asset in the hands of the taxpayer.

EFFECTIVE DATE OF 2002 AMENDMENT

Amendment by Pub. L. 107-147 effective as if included in the provisions of the Community Renewal Tax Relief Act of 2000 [H.R. 5662, as enacted by Pub. L. 106-554], to which such amendment relates, see section 412(e) of Pub. L. 107-147, set out as a note under section 151 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Section 1003(a)(2) of Pub. L. 105-34 provided that: “The amendment made by paragraph (1) [amending this section] shall apply to terminations more than 30 days after the date of the enactment of this Act [Aug. 5, 1997].”

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 102(e)(4) of Pub. L. 98-369 applicable to positions established after July 18, 1984, in taxable years ending after that date, except as otherwise provided, and amendment by section 102(e)(9) of Pub. L. 98-369, applicable as if included in the amendment made by section 507(a) of Pub. L. 97-34, as amended by section 105(e) of Pub. L. 97-448, see section 102(f), (g) of Pub. L. 98-369, set out as a note under section 1256 of this title.

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by Pub. L. 97-448 effective, except as otherwise provided, as if it had been included in the provision of the Economic Recovery Tax Act of 1981, Pub. L. 97-34, to which such amendment relates, see section 109 of Pub. L. 97-448, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable to property acquired and positions established by the taxpayer after June 23, 1981, in taxable years ending after such date, and applicable when so elected with respect to property held on June 23, 1981, see section 508 of Pub. L. 97-34, set out as a note under section 1092 of this title.

§ 1234B. Gains or losses from securities futures contracts

(a) Treatment of gain or loss

(1) In general

Gain or loss attributable to the sale, exchange, or termination of a securities futures contract shall be considered gain or loss from the sale or exchange of property which has the same character as the property to which the contract relates has in the hands of the taxpayer (or would have in the hands of the taxpayer if acquired by the taxpayer).

(2) Nonapplication of subsection

This subsection shall not apply to—

(A) a contract which constitutes property described in paragraph (1) or (7) of section 1221(a), and

(B) any income derived in connection with a contract which, without regard to this subsection, is treated as other than gain from the sale or exchange of a capital asset.

(b) Short-term gains and losses

Except as provided in the regulations under section 1092(b) or this section, or in section 1233, if gain or loss on the sale, exchange, or termination of a securities futures contract to sell property is considered as gain or loss from the sale or exchange of a capital asset, such gain or loss shall be treated as short-term capital gain or loss.

(c) Securities futures contract

For purposes of this section, the term “securities futures contract” means any security future (as defined in section 3(a)(55)(A) of the Securities Exchange Act of 1934, as in effect on the date of the enactment of this section). The Secretary may prescribe regulations regarding the status of contracts the values of which are determined directly or indirectly by reference to any index which becomes (or ceases to be) a narrow-based security index (as defined for purposes of section 1256(g)(6)).

(d) Contracts not treated as commodity futures contracts

For purposes of this title, a securities futures contract shall not be treated as a commodity futures contract.

(e) Regulations

The Secretary shall prescribe such regulations as may be appropriate to provide for the proper treatment of securities futures contracts under this title.

(f) Cross reference

For special rules relating to dealer securities futures contracts, see section 1256.

(Added Pub. L. 106-554, § 1(a)(7) [title IV, § 401(a)], Dec. 21, 2000, 114 Stat. 2763, 2763A-648; amended Pub. L. 107-147, title IV, § 412(d)(1)(B), (3)(B), Mar. 9, 2002, 116 Stat. 53, 54; Pub. L. 108-311, title IV, § 405(a)(1), Oct. 4, 2004, 118 Stat. 1188.)

REFERENCES IN TEXT

Section 3(a)(55)(A) of the Securities Exchange Act of 1934, referred to in subsec. (c), is classified to section 78c(a)(55)(A) of Title 15, Commerce and Trade.

The date of the enactment of this section, referred to in subsec. (c), is the date of enactment of Pub. L. 106-554, which was approved Dec. 21, 2000.

CODIFICATION

Pub. L. 106-554, § 1(a)(7) [title IV, § 401(a)], which directed amendment of subpart IV of subchapter P of chapter 1 by adding this section after section 1234A, was executed by adding this section after 1234A of this part which is part IV of subchapter P of chapter 1, to reflect the probable intent of Congress.

AMENDMENTS

2004—Subsec. (c). Pub. L. 108-311 inserted at end “The Secretary may prescribe regulations regarding the status of contracts the values of which are determined

directly or indirectly by reference to any index which becomes (or ceases to be) a narrow-based security index (as defined for purposes of section 1256(g)(6)).”

2002—Subsec. (a)(1). Pub. L. 107-147, § 412(d)(1)(B)(i), substituted “sale, exchange, or termination of a securities futures contract” for “sale or exchange of a securities futures contract”.

Subsec. (b). Pub. L. 107-147, § 412(d)(1)(B)(i), (3)(B), inserted “or in section 1233,” after “or this section,” and substituted “sale, exchange, or termination of a securities futures contract” for “sale or exchange of a securities futures contract”.

Subsec. (f). Pub. L. 107-147, § 412(d)(1)(B)(ii), added subsec. (f).

EFFECTIVE DATE OF 2004 AMENDMENT

Pub. L. 108-311, title IV, § 405(b), Oct. 4, 2004, 118 Stat. 1189, provided that: “The amendments made by subsection (a) [amending this section and section 1256 of this title] shall take effect as if included in section 401 of the Community Renewal Tax Relief Act of 2000 [H.R. 5662, as enacted by section 1(a)(7) of Pub. L. 106-554, Dec. 21, 2000, 114 Stat. 2763, 2763A-587].”

EFFECTIVE DATE OF 2002 AMENDMENT

Amendment by Pub. L. 107-147 effective as if included in the provisions of the Community Renewal Tax Relief Act of 2000 [H.R. 5662, as enacted by Pub. L. 106-554], to which such amendment relates, see section 412(e) of Pub. L. 107-147, set out as a note under section 151 of this title.

§ 1235. Sale or exchange of patents**(a) General**

A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 1 year, regardless of whether or not payments in consideration of such transfer are—

(1) payable periodically over a period generally coterminous with the transferee's use of the patent, or

(2) contingent on the productivity, use, or disposition of the property transferred.

(b) “Holder” defined

For purposes of this section, the term “holder” means—

(1) any individual whose efforts created such property, or

(2) any other individual who has acquired his interest in such property in exchange for consideration in money or money's worth paid to such creator prior to actual reduction to practice of the invention covered by the patent, if such individual is neither—

(A) the employer of such creator, nor

(B) related to such creator (within the meaning of subsection (d)).

(c) Effective date

This section shall be applicable with regard to any amounts received, or payments made, pursuant to a transfer described in subsection (a) in any taxable year to which this subtitle applies, regardless of the taxable year in which such transfer occurred.

(d) Related persons

Subsection (a) shall not apply to any transfer, directly or indirectly, between persons specified

within any one of the paragraphs of section 267(b) or persons described in section 707(b); except that, in applying section 267(b) and (c) and section 707(b) for purposes of this section—

(1) the phrase “25 percent or more” shall be substituted for the phrase “more than 50 percent” each place it appears in section 267(b) or 707(b), and

(2) paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants.

(e) Cross reference

For special rule relating to nonresident aliens, see section 871(a).

(Aug. 16, 1954, ch. 736, 68A Stat. 329; Pub. L. 85-866, title I, § 54(a), Sept. 2, 1958, 72 Stat. 1644; Pub. L. 94-455, title XIV, § 1402(b)(1)(V), (2), Oct. 4, 1976, 90 Stat. 1732; Pub. L. 98-369, div. A, title I, § 174(b)(5)(C), title X, § 1001(b)(19), (e), July 18, 1984, 98 Stat. 707, 1012; Pub. L. 105-206, title V, § 5001(a)(5), title VI, § 6005(d)(4), July 22, 1998, 112 Stat. 788, 805.)

AMENDMENTS

1998—Subsec. (a). Pub. L. 105-206, § 6005(d)(4), substituted “18 months” for “1 year” in introductory provisions.

Pub. L. 105-206, § 5001(a)(5), substituted “1 year” for “18 months” in introductory provisions.

1984—Subsec. (a). Pub. L. 98-369, § 1001(b)(19), (e), substituted “6 months” for “1 year”, applicable to property acquired after June 22, 1984, and before Jan. 1, 1988. See Effective Date of 1984 Amendment note below.

Subsec. (d). Pub. L. 98-369, § 174(b)(5)(C), substituted “section 267(b) or persons described in section 707(b)” for “section 267(b)” and “section 267(b) and (c) and section 707(b)” for “section 267(b) and (c)” in introductory provisions, and substituted “section 267(b) or 707(b)” for “section 267(b)” in par. (1).

1976—Subsec. (a). Pub. L. 94-455, § 1402(b)(2), provided that “9 months” would be changed to “1 year”.

Pub. L. 94-455, § 1402(b)(1)(V), provided that “6 months” would be changed to “9 months” for taxable years beginning in 1977.

1958—Subsec. (d). Pub. L. 85-866 substituted provisions set out as subsec. (d) for provisions reading “Subsection (a) shall not apply to any sale or exchange between an individual and any other related person (as defined in section 267(b)), except brothers and sisters, whether by the whole or half blood.”

EFFECTIVE DATE OF 1998 AMENDMENT

Amendment by section 5001 of Pub. L. 105-206 effective Jan. 1, 1998, see section 5001(b)(2) of Pub. L. 105-206, set out as a note under section 1 of this title.

Amendment by section 6000(d)(4) of Pub. L. 105-206 effective, except as otherwise provided, as if included in the provisions of the Taxpayer Relief Act of 1997, Pub. L. 105-34, to which such amendment relates, see section 6024 of Pub. L. 105-206, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 174(b)(5)(C) of Pub. L. 98-369 applicable to transactions after Dec. 31, 1983, in taxable years ending after that date, see section 174(c)(2)(A) of Pub. L. 98-369, set out as a note under section 267 of this title.

Amendment by section 1001(b)(19) of Pub. L. 98-369 applicable to property acquired after June 22, 1984, and before Jan. 1, 1988, see section 1001(e) of Pub. L. 98-369, set out as a note under section 166 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Section 1402(b)(1) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning in 1977.

Section 1402(b)(2) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning after Dec. 31, 1977.

EFFECTIVE DATE OF 1958 AMENDMENT

Section 54(b) of Pub. L. 85-866 provided that: “The amendment made by subsection (a) [amending this section] shall apply with respect to taxable years ending after the date of the enactment of this Act [Sept. 2, 1958], but only with respect to transfers after such date.”

§ 1236. Dealers in securities

(a) Capital gains

Gain by a dealer in securities from the sale or exchange of any security shall in no event be considered as gain from the sale or exchange of a capital asset unless—

(1) the security was, before the close of the day on which it was acquired (or such earlier time as the Secretary may prescribe by regulations), clearly identified in the dealer's records as a security held for investment; and

(2) the security was not, at any time after the close of such day (or such earlier time), held by such dealer primarily for sale to customers in the ordinary course of his trade or business.

(b) Ordinary losses

Loss by a dealer in securities from the sale or exchange of any security shall, except as otherwise provided in section 582(c), (relating to bond, etc., losses of banks), in no event be considered as ordinary loss if at any time after November 19, 1951, the security was clearly identified in the dealer's records as a security held for investment.

(c) Definition of security

For purposes of this section, the term “security” means any share of stock in any corporation, certificate of stock or interest in any corporation, note, bond, debenture, or evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing.

(d) Special rule for floor specialists

(1) In general

In the case of a floor specialist (but only with respect to acquisitions, in connection with his duties on an exchange, of stock in which the specialist is registered with the exchange), subsection (a) shall be applied—

(A) by inserting “the 7th business day following” before “the day” the first place it appears in paragraph (1) and by inserting “7th business” before “day” in paragraph (2), and

(B) by striking the parenthetical phrase in paragraph (1).

(2) Floor specialist

The term “floor specialist” means a person who is—

(A) a member of a national securities exchange,

(B) is registered as a specialist with the exchange, and

(C) meets the requirements for specialists established by the Securities and Exchange Commission.

(e) Special rule for options

For purposes of subsection (a), any security acquired by a dealer pursuant to an option held by such dealer may be treated as held for investment only if the dealer, before the close of the day on which the option was acquired, clearly identified the option on his records as held for investment. For purposes of the preceding sentence, the term “option” includes the right to subscribe to or purchase any security.

(Aug. 16, 1954, ch. 736, 68A Stat. 330; Pub. L. 94-455, title XIX, §1901(b)(3)(E), Oct. 4, 1976, 90 Stat. 1793; Pub. L. 97-34, title V, §506, Aug. 13, 1981, 95 Stat. 332; Pub. L. 97-448, title I, §105(d)(1), Jan. 12, 1983, 96 Stat. 2387; Pub. L. 98-369, div. A, title I, §107(b), July 18, 1984, 98 Stat. 630.)

AMENDMENTS

1984—Subsec. (a)(1). Pub. L. 98-369, §107(b)(1), substituted “the security was, before the close of the day on which it was acquired (or such earlier time as the Secretary may prescribe by regulations), clearly identified in the dealer’s records as a security held for investment; and” for “the security was, before the close of the day on which it was acquired (before the close of the following day in the case of an acquisition before January 1, 1982), clearly identified in the dealer’s records as a security held for investment or if acquired before October 20, 1951, was so identified before November 20, 1951; and”.

Subsec. (a)(2). Pub. L. 98-369, §107(b)(2), inserted “(or such earlier time)” after “such day”.

1983—Subsec. (e). Pub. L. 97-448 added subsec. (e).

1981—Subsec. (a). Pub. L. 97-34, §506(a), substituted “before the close of the day on which it was acquired (before the close of the following day in the case of an acquisition before January 1, 1982)” for “before the expiration of the 30th day after the date of its acquisition” in par. (1) and “close of such day” for “expiration of such 30th day” in par. (2).

Subsec. (d). Pub. L. 97-34, §506(b), added subsec. (d).

1976—Subsec. (b). Pub. L. 94-455 substituted “ordinary loss” for “loss from the sale or exchange of property which is not a capital asset”.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 applicable to positions entered into after July 18, 1984, in taxable years ending after that date, see section 107(e) of Pub. L. 98-369, set out as a note under section 1092 of this title.

EFFECTIVE DATE OF 1983 AMENDMENT

Section 105(d)(2) of Pub. L. 97-448 provided that: “The amendment made by paragraph (1) [amending this section] shall apply to securities acquired after September 22, 1982, in taxable years ending after such date.”

EFFECTIVE DATE OF 1981 AMENDMENT

Amendment by Pub. L. 97-34 applicable to property acquired by the taxpayer after Aug. 13, 1981, in taxable years ending after such date, and applicable when so elected with respect to property held on June 23, 1981, see section 508 of Pub. L. 97-34, set out as an Effective Date note under section 1092 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by Pub. L. 94-455 applicable with respect to taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

§ 1237. Real property subdivided for sale**(a) General**

Any lot or parcel which is part of a tract of real property in the hands of a taxpayer other

than a C corporation shall not be deemed to be held primarily for sale to customers in the ordinary course of trade or business at the time of sale solely because of the taxpayer having subdivided such tract for purposes of sale or because of any activity incident to such subdivision or sale, if—

(1) such tract, or any lot or parcel thereof, had not previously been held by such taxpayer primarily for sale to customers in the ordinary course of trade or business (unless such tract at such previous time would have been covered by this section) and, in the same taxable year in which the sale occurs, such taxpayer does not so hold any other real property; and

(2) no substantial improvement that substantially enhances the value of the lot or parcel sold is made by the taxpayer on such tract while held by the taxpayer or is made pursuant to a contract of sale entered into between the taxpayer and the buyer. For purposes of this paragraph, an improvement shall be deemed to be made by the taxpayer if such improvement was made by—

(A) the taxpayer or members of his family (as defined in section 267(c)(4)), by a corporation controlled by the taxpayer, an S corporation which included the taxpayer as a shareholder, or by a partnership which included the taxpayer as a partner; or

(B) a lessee, but only if the improvement constitutes income to the taxpayer; or

(C) Federal, State, or local government, or political subdivision thereof, but only if the improvement constitutes an addition to basis for the taxpayer; and

(3) such lot or parcel, except in the case of real property acquired by inheritance or devise, is held by the taxpayer for a period of 5 years.

(b) Special rules for application of section**(1) Gains**

If more than 5 lots or parcels contained in the same tract of real property are sold or exchanged, gain from any sale or exchange (which occurs in or after the taxable year in which the sixth lot or parcel is sold or exchanged) of any lot or parcel which comes within the provisions of paragraphs (1), (2) and (3) of subsection (a) of this section shall be deemed to be gain from the sale of property held primarily for sale to customers in the ordinary course of the trade or business to the extent of 5 percent of the selling price.

(2) Expenditures of sale

For the purpose of computing gain under paragraph (1) of this subsection, expenditures incurred in connection with the sale or exchange of any lot or parcel shall neither be allowed as a deduction in computing taxable income, nor treated as reducing the amount realized on such sale or exchange; but so much of such expenditures as does not exceed the portion of gain deemed under paragraph (1) of this subsection to be gain from the sale of property held primarily for sale to customers in the ordinary course of trade or business shall be so allowed as a deduction, and the re-

mainder, if any, shall be treated as reducing the amount realized on such sale or exchange.

(3) Necessary improvements

No improvement shall be deemed a substantial improvement for purposes of subsection (a) if the lot or parcel is held by the taxpayer for a period of 10 years and if—

(A) such improvement is the building or installation of water, sewer, or drainage facilities or roads (if such improvement would except for this paragraph constitute a substantial improvement);

(B) it is shown to the satisfaction of the Secretary that the lot or parcel, the value of which was substantially enhanced by such improvement, would not have been marketable at the prevailing local price for similar building sites without such improvement; and

(C) the taxpayer elects, in accordance with regulations prescribed by the Secretary, to make no adjustment to basis of the lot or parcel, or of any other property owned by the taxpayer, on account of the expenditures for such improvements. Such election shall not make any item deductible which would not otherwise be deductible.

(c) Tract defined

For purposes of this section, the term “tract of real property” means a single piece of real property, except that 2 or more pieces of real property shall be considered a tract if at any time they were contiguous in the hands of the taxpayer or if they would be contiguous except for the interposition of a road, street, railroad, stream, or similar property. If, following the sale or exchange of any lot or parcel from a tract of real property, no further sales or exchanges of any other lots or parcels from the remainder of such tract are made for a period of 5 years, such remainder shall be deemed a tract.

(Aug. 16, 1954, ch. 736, 68A Stat. 330; Apr. 27, 1956, ch. 214, §§1, 2, 70 Stat. 118; Pub. L. 85-866, title I, §55, Sept. 2, 1958, 72 Stat. 1645; Pub. L. 91-686, §2(a), Jan. 12, 1971, 84 Stat. 2071; Pub. L. 94-455, title XIX, §§1901(a)(138), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1787, 1834; Pub. L. 104-188, title I, §1314, Aug. 20, 1996, 110 Stat. 1785.)

AMENDMENTS

1996—Subsec. (a). Pub. L. 104-188, §1314(a), substituted “other than a C corporation” for “other than a corporation” in introductory provisions.

Subsec. (a)(2)(A). Pub. L. 104-188, §1314(b), inserted “an S corporation which included the taxpayer as a shareholder,” after “controlled by the taxpayer.”

1976—Subsec. (b)(3)(B), (C). Pub. L. 94-455, §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

Subsec. (d). Pub. L. 94-455, §1901(a)(138), struck out effective date provision making the section applicable only with respect to sales of property occurring after Dec. 31, 1953, except that for purposes of subsec. (c) defining tract of real property and for determining the number of sales under subsec. (b)(1) of this section, all sales of lots and parcels from any tract of real property during the period of 5 years before Dec. 31, 1953, shall be taken into account, except as provided in subsec. (c).

1971—Subsec. (a). Pub. L. 91-686, §2(a)(1), substituted “other than a corporation” for “(including corporations only if no shareholder directly or indirectly holds real property for sale to customers in the ordinary

course of trade or business and only in the case of property described in the last sentence of subsection (b)(3))”.

Subsec. (b). Pub. L. 91-686, §2(a)(2), struck out sentence which made subpars. (B) and (C) inapplicable in the case of property acquired through the foreclosure of a lien thereon which secured the payment of an indebtedness to the taxpayer or (in the case of a corporation) to a creditor who has transferred the foreclosure bid to the taxpayer in exchange for all of its stock and other consideration and in the case of property adjacent to such property if 80 percent of the real property owned by the taxpayer was property described in the first part of the sentence.

1958—Subsec. (a)(1). Pub. L. 85-866 substituted “and, in the same taxable year” for “or, in the same taxable year”.

1956—Subsec. (a). Act Apr. 27, 1956, §1, substituted “(including corporations only if no shareholder directly or indirectly holds real property for sale to customers in the ordinary course of trade or business and only in the case of property described in the last sentence of subsection (b)(3))” for “other than a corporation”.

Subsec. (b)(3). Act Apr. 27, 1956, §2, substituted “water, sewer, or drainage facilities” for “water or sewer facilities” in subpar. (A), and inserted provision at end that requirements of subpars. (B) and (C) do not apply to certain specified property.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 applicable to taxable years beginning after Dec. 31, 1996, see section 1317(a) of Pub. L. 104-188, set out as a note under section 641 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by section 1901(a)(138) of Pub. L. 94-455 applicable with respect to taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

EFFECTIVE DATE OF 1971 AMENDMENT

Section 2(b) of Pub. L. 91-686 provided that: “The amendments made by subsection (a) [amending this section] shall be effective for taxable years beginning after the date of enactment of this Act [Jan. 12, 1971].”

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment by Pub. L. 85-866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1(c)(1) of Pub. L. 85-866, set out as a note under section 165 of this title.

EFFECTIVE DATE OF 1956 AMENDMENT

Section 3 of act Apr. 27, 1956, provided that: “This Act [amending this section] shall apply to all taxable years beginning after Dec. 31, 1954.”

SALES OR EXCHANGES BY CORPORATIONS OF REAL PROPERTY HELD MORE THAN 25 YEARS

Section 1 of Pub. L. 91-686, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided: “That (a) for purposes of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] any lot or parcel of real property sold or exchanged by a corporation which would, but for this Act, be treated as property held primarily for sale to customers in the ordinary course of trade or business shall not, except to the extent provided in (b), be so treated if—

“(1) no shareholder of the corporation directly or indirectly holds real property primarily for sale to customers in the ordinary course of trade or business; and

“(2)(A) such lot or parcel is a part of real property (i) held for more than twenty-five years at the time of sale or exchange, and (ii) acquired before January 1, 1934, by the corporation as a result of the foreclosure of a lien (or liens) thereon which secured the

payment of indebtedness held by one or more creditors who transferred one or more foreclosure bids to the corporation in exchange for all its stock (with or without other consideration), or

“(B)(i) such lot or parcel is a part of additional real property acquired before January 1, 1957, by the corporation in the near vicinity of any real property to which subparagraph (A) applies, or

“(ii) such lot or parcel is wholly or to some extent a part of any minor acquisition made after December 31, 1956, by the corporation to adjust boundaries, to fill gaps in previously acquired property, to facilitate the installation of streets, utilities, and other public facilities, or to facilitate the sale of adjacent property, or

“(iii) such lot or parcel is wholly or to some extent a part of a reacquisition by the corporation after December 31, 1956, of property previously owned by the corporation;

but only if at least 80 percent (as measured by area) of the real property sold or exchanged by the corporation within the taxable year is property described in subparagraph (A); and

“(3) there were no acquisitions of real property by the corporation after December 31, 1956, other than—

“(A) acquisitions described in paragraph (2)(B)(ii) and reacquisitions described in paragraph (2)(B)(iii), or

“(B) acquisitions of real property used in a trade or business of the corporation or held for investment by the corporation; and

“(4) the corporation did not after December 31, 1957, sell or exchange (except in condemnation or under threat of condemnation) any residential lot or parcel on which, at the time of the sale or exchange, there existed any substantial improvements (other than improvements in existence at the time the land was acquired by the corporation) except subdivision, clearing, grubbing, and grading, building or installation of water, sewer, and drainage facilities, construction of roads, streets, and sidewalks, and installation of utilities.”

In any case in which a corporation referred to in paragraphs (1), (2), (3), and (4) is a member of an affiliated group as defined in section 1504(a) of the Internal Revenue Code of 1986, such affiliated group shall, for purposes of such paragraphs, be treated as a single corporation.

“(b)(1) Gain from any sale or exchange described in subsection (a) shall be deemed, for purposes of such Code, to be gain from the sale of property held primarily for sale to customers in the ordinary course of trade or business to the extent of 5 percent of the selling price.

“(2) For the purpose of computing gain under paragraph (1), expenditures incurred in connection with the sale or exchange of any lot or parcel shall neither be allowed as a deduction in computing taxable income, nor treated as reducing the amount realized on such sale or exchange; but so much of such expenditures as does not exceed the portion of gain deemed under paragraph (1) to be gain from the sale of property held primarily for sale to customers in the ordinary course of trade or business shall be so allowed as a deduction, and the remainder, if any, shall be treated as reducing the amount realized on such sale or exchange.

“(c) The provisions of subsections (a) and (b) shall apply to taxable years beginning after December 31, 1957, and before January 1, 1984.”

[§ 1238. Repealed. Pub. L. 101-508, title XI, § 11801(a)(35), Nov. 5, 1990, 104 Stat. 1388-521]

Section, acts Aug. 16, 1954, ch. 736, 68A Stat. 332; Oct. 4, 1976, Pub. L. 94-455, title XIX, §§ 1901(b)(3)(K), 1951(c)(2)(A), 90 Stat. 1793, 1840, related to amortization in excess of depreciation.

SAVINGS PROVISION

For provisions that nothing in repeal by Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

§ 1239. Gain from sale of depreciable property between certain related taxpayers

(a) Treatment of gain as ordinary income

In the case of a sale or exchange of property, directly or indirectly, between related persons, any gain recognized to the transferor shall be treated as ordinary income if such property is, in the hands of the transferee, of a character which is subject to the allowance for depreciation provided in section 167.

(b) Related persons

For purposes of subsection (a), the term “related persons” means—

(1) a person and all entities which are controlled entities with respect to such person,

(2) a taxpayer and any trust in which such taxpayer (or his spouse) is a beneficiary, unless such beneficiary’s interest in the trust is a remote contingent interest (within the meaning of section 318(a)(3)(B)(i)), and

(3) except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.

(c) Controlled entity defined

(1) General rule

For purposes of this section, the term “controlled entity” means, with respect to any person—

(A) a corporation more than 50 percent of the value of the outstanding stock of which is owned (directly or indirectly) by or for such person,

(B) a partnership more than 50 percent of the capital interest or profits interest in which is owned (directly or indirectly) by or for such person, and

(C) any entity which is a related person to such person under paragraph (3), (10), (11), or (12) of section 267(b).

(2) Constructive ownership

For purposes of this section, ownership shall be determined in accordance with rules similar to the rules under section 267(c) (other than paragraph (3) thereof).

(d) Employer and related employee association

For purposes of subsection (a), the term “related person” also includes—

(1) an employer and any person related to the employer (within the meaning of subsection (b)), and

(2) a welfare benefit fund (within the meaning of section 419(e)) which is controlled directly or indirectly by persons referred to in paragraph (1).

(e) Patent applications treated as depreciable property

For purposes of this section, a patent application shall be treated as property which, in the

hands of the transferee, is of a character which is subject to the allowance for depreciation provided in section 167.

(Aug. 16, 1954, ch. 736, 68A Stat. 332; Pub. L. 85-866, title I, § 56, Sept. 2, 1958, 72 Stat. 1645; Pub. L. 94-455, title XXI, § 2129(a), Oct. 4, 1976, 90 Stat. 1922; Pub. L. 95-600, title VII, § 701(v)(1), Nov. 6, 1978, 92 Stat. 2920; Pub. L. 96-471, § 5, Oct. 19, 1980, 94 Stat. 2255; Pub. L. 97-448, title III, § 301, Jan. 12, 1983, 96 Stat. 2397; Pub. L. 98-369, div. A, title I, § 175(a), (b), title IV, § 421(b)(6)(A), title V, § 557(a), July 18, 1984, 98 Stat. 708, 794, 898; Pub. L. 99-514, title VI, § 642(a)(1)(A)-(C), Oct. 22, 1986, 100 Stat. 2283, 2284; Pub. L. 105-34, title XIII, § 1308(b), Aug. 5, 1997, 111 Stat. 1041.)

AMENDMENTS

1997—Subsec. (b)(3). Pub. L. 105-34 added par. (3).

1986—Subsec. (b)(1). Pub. L. 99-514, § 642(a)(1)(A), substituted “controlled entities” for “80-percent owned entities”.

Subsec. (c). Pub. L. 99-514, § 642(a)(1)(B), (C), in heading, substituted “Controlled entity” for “80-percent owned entity”, in par. (1), in introductory provisions, substituted “controlled entity” for “80-percent owned entity”, in subpar. (A), substituted “more than 50 percent of the value” for “80 percent or more in value”, in subpar. (B), substituted “more than 50 percent” for “80 percent or more”, and added subpar. (C), and amended par. (2) generally. Prior to amendment, par. (2) read as follows: “For purposes of subparagraphs (A) and (B) of paragraph (1), the principles of section 318 shall apply, except that—

“(A) the members of an individual’s family shall consist only of such individual and such individual’s spouse,

“(B) paragraph (2)(C) of section 318(a) shall be applied without regard to the 50-percent limitation contained therein, and

“(C) paragraph (3) of section 318(a) shall not apply.”

1984—Subsec. (b). Pub. L. 98-369, § 421(b)(6), redesignated pars. (2) and (3) as (1) and (2), respectively. Former par. (1), defining a husband and wife as “related persons”, was struck out.

Pub. L. 98-369, § 175(b), amended subsec. (b) generally, adding par. (3).

Subsec. (d). Pub. L. 98-369, § 557(a), added subsec. (d).

Subsec. (e). Pub. L. 98-369, § 175(a), added subsec. (e).

1983—Subsec. (b). Pub. L. 97-448, § 301(a), substituted provisions that “related persons” means (1) a husband and wife, and (2) a person and all entities which are 80-percent owned entities with respect to such person, for provisions which provided that “related persons” meant (1) the taxpayer and the taxpayer’s spouse, (2) the taxpayer and an 80-percent owned entity, or (3) two 80-percent owned entities.

Subsec. (c)(1). Pub. L. 97-448, § 301(b), inserted “, with respect to any person” after “means” in introductory provisions and substituted “such person” for “the taxpayer” in subpars. (A) and (B).

Subsec. (c)(2). Pub. L. 97-448, § 301(b), struck out “and” at end of subpar. (A), substituted “paragraph (2)(C)” for “paragraphs (2)(C) and (3)(C)” in subpar. (B), and added subpar. (C).

1980—Subsec. (b)(1). Pub. L. 96-471 substituted “the taxpayer and the taxpayer’s spouse” for “a husband and wife”.

Subsec. (b)(2). Pub. L. 96-471 substituted “the taxpayer and an 80-percent owned entity, or” for “an individual and a corporation 80 percent or more in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual, or”.

Subsec. (b)(3). Pub. L. 96-471 substituted “two 80-percent owned entities” for “two or more corporations 80 percent or more in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual”.

Subsec. (c). Pub. L. 96-471 substituted provisions defining an “80-percent owned entity” for provisions relating to constructive ownership of stock.

1978—Subsec. (a). Pub. L. 95-600 substituted “of a character which is subject to the allowance for depreciation provided in section 167” for “subject to the allowance for depreciation provided in section 167”.

1976—Pub. L. 94-455 substituted “sale of depreciable property between certain related taxpayers” for “sale of certain property between spouses or between an individual and a controlled corporation” in section catchline.

Subsec. (a). Pub. L. 94-455 substituted provisions for transactions between related persons for such transactions (1) between a husband and wife; or (2) between an individual and a corporation more than 80 percent in value of the outstanding stock of which is owned by such individual, his spouse, and his minor children and minor grandchildren and “any gain recognized to the transferee shall be treated as ordinary income if such property is, in the hands of the transferee, subject to the allowance for depreciation provided in section 167” for “any gain recognized to the transferor from the sale or exchange of such property shall be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231”.

Subsec. (b). Pub. L. 94-455 substituted definition of “related persons” for prior provision making section applicable only to sales or exchanges of depreciable property.

Subsec. (c). Pub. L. 94-455 substituted provision respecting constructive ownership of stock for prior provision making section inapplicable with respect to sales or exchanges made on or before May 3, 1951.

1958—Subsec. (c). Pub. L. 85-866 added subsec. (c).

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 applicable to taxable years beginning after Aug. 5, 1997, see section 1308(c) of Pub. L. 105-34, set out as a note under section 267 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Section 642(c) of Pub. L. 99-514, as amended by Pub. L. 100-647, title I, § 1006(i)(3), Nov. 10, 1988, 102 Stat. 3411, provided that:

“(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section [amending this section and sections 453 and 707 of this title] shall apply to sales after the date of the enactment of this Act [Oct. 22, 1986], in taxable years ending after such date.

“(2) TRANSITIONAL RULE FOR BINDING CONTRACTS.—The amendments made by this section shall not apply to sales made after August 14, 1986, which are made pursuant to a binding contract in effect on August 14, 1986, and at all times thereafter.”

EFFECTIVE DATE OF 1984 AMENDMENT

Section 175(c) of Pub. L. 98-369 provided that: “The amendments made by this section [amending this section] shall apply to sales or exchanges after March 1, 1984, in taxable years ending after such date.”

Amendment by section 421(b)(6) of Pub. L. 98-369 applicable to transfers after July 18, 1984, in taxable years ending after such date, subject to election to have amendment apply to transfers after 1983 or to transfers pursuant to existing decrees, see section 421(d) of Pub. L. 98-369, set out as an Effective Date note under section 1041 of this title.

Section 557(b) of Pub. L. 98-369 provided that: “The amendment made by subsection (a) [amending this section] shall apply to sales or exchanges after the date of the enactment of this Act [July 18, 1984] in taxable years ending after such date.”

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by Pub. L. 97-448 applicable to dispositions made after Oct. 19, 1980, in taxable years ending

after such date, see section 311(a) of Pub. L. 97-448, set out as a note under section 453 of this title.

EFFECTIVE DATE OF 1978 AMENDMENT

Section 701(v)(2) of Pub. L. 95-600, as amended by Pub. L. 99-514, § 2, Oct. 22, 1986, 100 Stat. 2095, provided that: "The amendment made by paragraph (1) [amending this section] shall apply as if included in the amendment made to section 1239 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] by section 2129(a) of the Tax Reform Act of 1976 [section 2129(a) of Pub. L. 94-455]."

EFFECTIVE DATE OF 1976 AMENDMENT

Section 2129(b) of Pub. L. 94-455 provided that: "The amendment made by this section [amending this section] shall apply to sales or exchanges after the date of the enactment of this Act [Oct. 4, 1976]. For purposes of the preceding sentence, a sale or exchange is considered to have occurred on or before such date of enactment if such sale or exchange is made pursuant to a binding contract entered into on or before that date."

[§ 1240. Repealed. Pub. L. 94-455, title XIX, § 1901(a)(139), Oct. 4, 1976, 90 Stat. 1787]

Section, act Aug. 16, 1954, ch. 736, 68A Stat. 332, related to taxability to employee of termination payments.

EFFECTIVE DATE OF REPEAL

Repeal applicable with respect to taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as an Effective Date of 1976 Amendment note under section 2 of this title.

§ 1241. Cancellation of lease or distributor's agreement

Amounts received by a lessee for the cancellation of a lease, or by a distributor of goods for the cancellation of a distributor's agreement (if the distributor has a substantial capital investment in the distributorship), shall be considered as amounts received in exchange for such lease or agreement.

(Aug. 16, 1954, ch. 736, 68A Stat. 333.)

§ 1242. Losses on small business investment company stock

If—

(1) a loss is on stock in a small business investment company operating under the Small Business Investment Act of 1958, and

(2) such loss would (but for this section) be a loss from the sale or exchange of a capital asset,

then such loss shall be treated as an ordinary loss. For purposes of section 172 (relating to the net operating loss deduction) any amount of loss treated by reason of this section as an ordinary loss shall be treated as attributable to a trade or business of the taxpayer.

(Added Pub. L. 85-866, title I, § 57(a), Sept. 2, 1958, 72 Stat. 1645; amended Pub. L. 94-455, title XIX, § 1901(b)(3)(F), Oct. 4, 1976, 90 Stat. 1793.)

REFERENCES IN TEXT

The Small Business Investment Act of 1958, referred to in cl. (1), is Pub. L. 85-699, Aug. 21, 1958, 72 Stat. 689, as amended, which is classified principally to chapter 14B (§ 661 et seq.) of Title 15, Commerce and Trade. For complete classification of this Act to the Code, see Short Title note set out under section 661 of Title 15 and Tables.

AMENDMENTS

1976—Pub. L. 94-455 substituted "an ordinary loss" for "a loss from the sale or exchange of property which is not a capital asset", each time appearing.

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by Pub. L. 94-455 applicable with respect to taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Sept. 2, 1958, see section 57(d) of Pub. L. 85-866, set out as an Effective Date of 1958 Amendment note under section 243 of this title.

§ 1243. Loss of small business investment company

In the case of a small business investment company operating under the Small Business Investment Act of 1958, if—

(1) a loss is on stock received pursuant to the conversion privilege of convertible debentures acquired pursuant to section 304 of the Small Business Investment Act of 1958, and

(2) such loss would (but for this section) be a loss from the sale or exchange of a capital asset,

then such loss shall be treated as an ordinary loss.

(Added Pub. L. 85-866, title I, § 57(a), Sept. 2, 1958, 72 Stat. 1645; amended Pub. L. 91-172, title IV, § 433(b), Dec. 30, 1969, 83 Stat. 624; Pub. L. 94-455, title XIX, § 1901(b)(3)(F), Oct. 4, 1976, 90 Stat. 1793.)

REFERENCES IN TEXT

The Small Business Investment Act of 1958, referred to in text, is Pub. L. 85-699, Aug. 21, 1958, 72 Stat. 689, as amended, which is classified principally to chapter 14B (§ 661 et seq.) of Title 15, Commerce and Trade. Section 304 of the Small Business Investment Act of 1958, is classified to section 684 of Title 15. For complete classification of this Act to the Code, see Short Title note set out under section 661 of Title 15 and Tables.

AMENDMENTS

1976—Pub. L. 94-455 substituted "an ordinary loss" for "a loss from the sale or exchange of property which is not a capital asset".

1969—Par. (1). Pub. L. 91-172 substituted "stock received pursuant to the conversion privilege of convertible debentures" for "convertible debentures (including stock received pursuant to the conversion privilege)".

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by Pub. L. 94-455 applicable with respect to taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by Pub. L. 91-172 applicable to taxable years beginning after July 11, 1969, see section 433(d) of Pub. L. 91-172, set out as a note under section 582 of this title.

EFFECTIVE DATE

Section applicable with respect to taxable years beginning after Sept. 2, 1958, see section 57(d) of Pub. L. 85-866, set out as an Effective Date of 1958 Amendment note under section 243 of this title.

§ 1244. Losses on small business stock**(a) General rule**

In the case of an individual, a loss on section 1244 stock issued to such individual or to a partnership which would (but for this section) be treated as a loss from the sale or exchange of a capital asset shall, to the extent provided in this section, be treated as an ordinary loss.

(b) Maximum amount for any taxable year

For any taxable year the aggregate amount treated by the taxpayer by reason of this section as an ordinary loss shall not exceed—

- (1) \$50,000, or
- (2) \$100,000, in the case of a husband and wife filing a joint return for such year under section 6013.

(c) Section 1244 stock defined**(1) In general**

For purposes of this section, the term “section 1244 stock” means stock in a domestic corporation if—

(A) at the time such stock is issued, such corporation was a small business corporation,

(B) such stock was issued by such corporation for money or other property (other than stock and securities), and

(C) such corporation, during the period of its 5 most recent taxable years ending before the date the loss on such stock was sustained, derived more than 50 percent of its aggregate gross receipts from sources other than royalties, rents, dividends, interests, annuities, and sales or exchanges of stocks or securities.

(2) Rules for application of paragraph (1)(C)**(A) Period taken into account with respect to new corporations**

For purposes of paragraph (1)(C), if the corporation has not been in existence for 5 taxable years ending before the date the loss on the stock was sustained, there shall be substituted for such 5-year period—

- (i) the period of the corporation’s taxable years ending before such date, or
- (ii) if the corporation has not been in existence for 1 taxable year ending before such date, the period such corporation has been in existence before such date.

(B) Gross receipts from sales of securities

For purposes of paragraph (1)(C), gross receipts from the sales or exchanges of stock or securities shall be taken into account only to the extent of gains therefrom.

(C) Nonapplication where deductions exceed gross income

Paragraph (1)(C) shall not apply with respect to any corporation if, for the period taken into account for purposes of paragraph (1)(C), the amount of the deductions allowed by this chapter (other than by sections 172, 243, 244, and 245) exceeds the amount of gross income.

(3) Small business corporation defined**(A) In general**

For purposes of this section, a corporation shall be treated as a small business corpora-

tion if the aggregate amount of money and other property received by the corporation for stock, as a contribution to capital, and as paid-in surplus, does not exceed \$1,000,000. The determination under the preceding sentence shall be made as of the time of the issuance of the stock in question but shall include amounts received for such stock and for all stock theretofore issued.

(B) Amount taken into account with respect to property

For purposes of subparagraph (A), the amount taken into account with respect to any property other than money shall be the amount equal to the adjusted basis to the corporation of such property for determining gain, reduced by any liability to which the property was subject or which was assumed by the corporation. The determination under the preceding sentence shall be made as of the time the property was received by the corporation.

(d) Special rules**(1) Limitations on amount of ordinary loss****(A) Contributions of property having basis in excess of value**

If—

(i) section 1244 stock was issued in exchange for property,

(ii) the basis of such stock in the hands of the taxpayer is determined by reference to the basis in his hands of such property, and

(iii) the adjusted basis (for determining loss) of such property immediately before the exchange exceeded its fair market value at such time,

then in computing the amount of the loss on such stock for purposes of this section the basis of such stock shall be reduced by an amount equal to the excess described in clause (iii).

(B) Increases in basis

In computing the amount of the loss on stock for purposes of this section, any increase in the basis of such stock (through contributions to the capital of the corporation, or otherwise) shall be treated as allocable to stock which is not section 1244 stock.

(2) Recapitalizations, changes in name, etc.

To the extent provided in regulations prescribed by the Secretary, stock in a corporation, the basis of which (in the hands of a taxpayer) is determined in whole or in part by reference to the basis in his hands of stock in such corporation which meets the requirements of subsection (c)(1) (other than subparagraph (C) thereof), or which is received in a reorganization described in section 368(a)(1)(F) in exchange for stock which meets such requirements, shall be treated as meeting such requirements. For purposes of paragraphs (1)(C) and (3)(A) of subsection (c), a successor corporation in a reorganization described in section 368(a)(1)(F) shall be treated as the same corporation as its predecessor.

(3) Relationship to net operating loss deduction

For purposes of section 172 (relating to the net operating loss deduction), any amount of loss treated by reason of this section as an ordinary loss shall be treated as attributable to a trade or business of the taxpayer.

(4) Individual defined

For purposes of this section, the term “individual” does not include a trust or estate.

(e) Regulations

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section.

(Added Pub. L. 85-866, title II, §202(b), Sept. 2, 1958, 72 Stat. 1676; amended Pub. L. 94-455, title XIX, §§1901(b)(1)(W), (3)(G), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1792, 1793, 1834; Pub. L. 95-600, title III, §345(a)-(d), Nov. 6, 1978, 92 Stat. 2844, 2845; Pub. L. 98-369, div. A, title IV, §481(a), July 18, 1984, 98 Stat. 847.)

AMENDMENTS

1984—Subsecs. (c)(1), (d)(2). Pub. L. 98-369 substituted “stock in a” for “common stock in a”.

1978—Subsec. (b). Pub. L. 95-600, §345(b), substituted in par. (1) “\$50,000” for “\$25,000” and in par. (2) “\$100,000” for “\$50,000”.

Subsec. (c). Pub. L. 95-600, §345(a), (c), among other changes, substituted provisions permitting a corporation to issue common stock under the provisions of this section without a written plan for provisions requiring that a written plan to issue section 1244 stock must be adopted by the issuing corporation and increased the amount of section 1244 stock that a qualified small business corporation may issue from \$500,000 to \$1,000,000.

Subsec. (d)(2). Pub. L. 95-600, §345(d), substituted “subparagraph (C)” for “subparagraph (E)” and “paragraphs (1)(C) and (3)(A)” for “paragraphs (1)(E) and (2)(A)”.

1976—Subsecs. (a), (b). Pub. L. 94-455, §1901(b)(3)(G), substituted “an ordinary loss” for “a loss from the sale or exchange of an asset which is not a capital asset”.

Subsec. (c)(1)(E). Pub. L. 94-455, §1901(b)(1)(W), struck out reference to section 242 of this title.

Subsec. (d)(2). Pub. L. 94-455, §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

Subsec. (d)(3). Pub. L. 94-455, §1901(b)(3)(G), substituted “an ordinary loss” for “a loss from the sale or exchange of an asset which is not a capital asset”.

EFFECTIVE DATE OF 1984 AMENDMENT

Section 481(b) of Pub. L. 98-369 provided that: “The amendment made by subsection (a) [amending this section] shall apply to stock issued after the date of the enactment of this Act [July 18, 1984] in taxable years ending after such date.”

EFFECTIVE DATE OF 1978 AMENDMENT

Section 345(e) of Pub. L. 95-600, as amended by Pub. L. 96-222, title I, §103(a)(9), Apr. 1, 1980, 94 Stat. 212, provided that:

“(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section [amending this section] shall apply to stock issued after November 6, 1978.

“(2) SUBSECTION (b).—The amendments made by subsection (b) [amending this section] shall apply to taxable years beginning after December 31, 1978.

“(3) TRANSITIONAL RULE FOR SUBSECTION (b).—In the case of a taxable year which includes November 6, 1978, the amendments made by subsection (b) [amending this section] shall apply with respect to stock issued after such date.”

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by section 1901(b)(1)(W), (3)(G) of Pub. L. 94-455 effective for taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

§ 1245. Gain from dispositions of certain depreciable property

(a) General rule

(1) Ordinary income

Except as otherwise provided in this section, if section 1245 property is disposed of the amount by which the lower of—

(A) the recomputed basis of the property, or

(B)(i) in the case of a sale, exchange, or involuntary conversion, the amount realized, or

(ii) in the case of any other disposition, the fair market value of such property,

exceeds the adjusted basis of such property shall be treated as ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(2) Recomputed basis

For purposes of this section—

(A) In general

The term “recomputed basis” means, with respect to any property, its adjusted basis recomputed by adding thereto all adjustments reflected in such adjusted basis on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for depreciation or amortization.

(B) Taxpayer may establish amount allowed

For purposes of subparagraph (A), if the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed for depreciation or amortization for any period was less than the amount allowable, the amount added for such period shall be the amount allowed.

(C) Certain deductions treated as amortization

Any deduction allowable under section 179, 179A, 179B, 179C, 179D, 179E, 181, 190, 193, or 194 shall be treated as if it were a deduction allowable for amortization.

(3) Section 1245 property

For purposes of this section, the term “section 1245 property” means any property which is or has been property of a character subject to the allowance for depreciation provided in section 167 and is either—

(A) personal property,

(B) other property (not including a building or its structural components) but only if such other property is tangible and has an adjusted basis in which there are reflected adjustments described in paragraph (2) for a period in which such property (or other property)—

(i) was used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communica-

tions, electrical energy, gas, water, or sewage disposal services,

(ii) constituted a research facility used in connection with any of the activities referred to in clause (i), or

(iii) constituted a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state),

(C) so much of any real property (other than any property described in subparagraph (B)) which has an adjusted basis in which there are reflected adjustments for amortization under section 169, 179, 179A, 179B, 179C, 179D, 179E, 185,¹ 188 (as in effect before its repeal by the Revenue Reconciliation Act of 1990), 190, 193, or 194,²

(D) a single purpose agricultural or horticultural structure (as defined in section 168(i)(13)),

(E) a storage facility (not including a building or its structural components) used in connection with the distribution of petroleum or any primary product of petroleum, or

(F) any railroad grading or tunnel bore (as defined in section 168(e)(4)).

(b) Exceptions and limitations

(1) Gifts

Subsection (a) shall not apply to a disposition by gift.

(2) Transfers at death

Except as provided in section 691 (relating to income in respect of a decedent), subsection (a) shall not apply to a transfer at death.

(3) Certain tax-free transactions

If the basis of property in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 721, or 731, then the amount of gain taken into account by the transferor under subsection (a)(1) shall not exceed the amount of gain recognized to the transferor on the transfer of such property (determined without regard to this section). Except as provided in paragraph (6), this paragraph shall not apply to a disposition to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter.

(4) Like kind exchanges; involuntary conversions, etc.

If property is disposed of and gain (determined without regard to this section) is not recognized in whole or in part under section 1031 or 1033, then the amount of gain taken into account by the transferor under subsection (a)(1) shall not exceed the sum of—

(A) the amount of gain recognized on such disposition (determined without regard to this section), plus

(B) the fair market value of property acquired which is not section 1245 property and which is not taken into account under subparagraph (A).

¹ See References in Text note below.

² Comma added editorially.

(5) Property distributed by a partnership to a partner

(A) In general

For purposes of this section, the basis of section 1245 property distributed by a partnership to a partner shall be deemed to be determined by reference to the adjusted basis of such property to the partnership.

(B) Adjustments added back

In the case of any property described in subparagraph (A), for purposes of computing the recomputed basis of such property the amount of the adjustments added back for periods before the distribution by the partnership shall be—

(i) the amount of the gain to which subsection (a) would have applied if such property had been sold by the partnership immediately before the distribution at its fair market value at such time, reduced by

(ii) the amount of such gain to which section 751(b) applied.

(6) Transfers to tax-exempt organization where property will be used in unrelated business

(A) In general

The second sentence of paragraph (3) shall not apply to a disposition of section 1245 property to an organization described in section 511(a)(2) or 511(b)(2) if, immediately after such disposition, such organization uses such property in an unrelated trade or business (as defined in section 513).

(B) Later change in use

If any property with respect to the disposition of which gain is not recognized by reason of subparagraph (A) ceases to be used in an unrelated trade or business of the organization acquiring such property, such organization shall be treated for purposes of this section as having disposed of such property on the date of such cessation.

(7) Timber property

In determining, under subsection (a)(2), the recomputed basis of property with respect to which a deduction under section 194 was allowed for any taxable year, the taxpayer shall not take into account adjustments under section 194 to the extent such adjustments are attributable to the amortizable basis of the taxpayer acquired before the 10th taxable year preceding the taxable year in which gain with respect to the property is recognized.

(8) Disposition of amortizable section 197 intangibles

(A) In general

If a taxpayer disposes of more than 1 amortizable section 197 intangible (as defined in section 197(c)) in a transaction or a series of related transactions, all such amortizable 197 intangibles shall be treated as 1 section 1245 property for purposes of this section.

(B) Exception

Subparagraph (A) shall not apply to any amortizable section 197 intangible (as so defined) with respect to which the adjusted basis exceeds the fair market value.

(c) Adjustments to basis

The Secretary shall prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain recognized under subsection (a).

(d) Application of section

This section shall apply notwithstanding any other provision of this subtitle.

(Added Pub. L. 87-834, §13(a)(1), Oct. 16, 1962, 76 Stat. 1032; amended Pub. L. 88-272, title II, §203(d), Feb. 26, 1964, 78 Stat. 35; Pub. L. 91-172, title II, §212(a)(1), (2), title VII, §704(b)(4), Dec. 30, 1969, 83 Stat. 571, 670; Pub. L. 92-178, title I, §104(a)(2), title III, §303(c)(1), (2), Dec. 10, 1971, 85 Stat. 501, 522; Pub. L. 94-81, §2(a), Aug. 9, 1975, 89 Stat. 417; Pub. L. 94-455, title II, §212(b)(1), title XIX, §§1901(a)(140), (b)(3)(K), (11)(D), 1906(b)(13)(A), 1951(c)(2)(C), title XXI, §§2122(b)(3), 2124(a)(2), Oct. 4, 1976, 90 Stat. 1546, 1787, 1793, 1795, 1834, 1840, 1915, 1917; Pub. L. 95-600, title VII, §701(f)(3)(A), (B), (w)(1), (2), Nov. 6, 1978, 92 Stat. 2901, 2920; Pub. L. 96-223, title II, §251(a)(2)(C), Apr. 2, 1980, 94 Stat. 287; Pub. L. 96-451, title III, §301(c)(1), Oct. 14, 1980, 94 Stat. 1990; Pub. L. 97-34, title II, §§201(b), 202(b), 204(a)-(d), 212(d)(2)(F), Aug. 13, 1981, 95 Stat. 218, 220, 222, 223, 239; Pub. L. 97-448, title I, §102(e)(2)(B), Jan. 12, 1983, 96 Stat. 2371; Pub. L. 98-369, div. A, title I, §111(e)(5), (10), July 18, 1984, 98 Stat. 633; Pub. L. 99-121, title I, §103(b)(1)(D), Oct. 11, 1985, 99 Stat. 509; Pub. L. 99-514, title II, §201(d)(11), Oct. 22, 1986, 100 Stat. 2141; Pub. L. 100-647, title I, §1002(i)(2)(I), Nov. 10, 1988, 102 Stat. 3371; Pub. L. 101-239, title VII, §7622(b)(2)[(d)(2)], Dec. 19, 1989, 103 Stat. 2378; Pub. L. 101-508, title XI, §§11704(a)(13), 11801(c)(6)(E), (8)(H), 11813(b)(21), Nov. 5, 1990, 104 Stat. 1388-518, 1388-524, 1388-555; Pub. L. 103-66, title XIII, §13261(f)(4), (5), Aug. 10, 1993, 107 Stat. 539; Pub. L. 104-7, §2(b), Apr. 11, 1995, 109 Stat. 93; Pub. L. 104-188, title I, §1703(n)(6), Aug. 20, 1996, 110 Stat. 1877; Pub. L. 105-34, title XVI, §1604(a)(3), Aug. 5, 1997, 111 Stat. 1097; Pub. L. 108-357, title III, §338(b)(5), title VIII, §886(b)(2), Oct. 22, 2004, 118 Stat. 1481, 1641; Pub. L. 109-58, title XIII, §§1323(b)(1), 1331(b)(2), 1363(a), Aug. 8, 2005, 119 Stat. 1014, 1024, 1060; Pub. L. 109-135, title IV, §§402(a)(6), 403(e)(2), (i)(2), Dec. 21, 2005, 119 Stat. 2610, 2623, 2625; Pub. L. 109-432, div. A, title IV, §404(b)(3), Dec. 20, 2006, 120 Stat. 2956.)

REFERENCES IN TEXT

Section 185 of this title, referred to in subsec. (a)(3)(C), was repealed by Pub. L. 99-514, title II, §242(a), Oct. 22, 1986, 100 Stat. 2181.

The Revenue Reconciliation Act of 1990, referred to in subsec. (a)(3)(C), is title XI of Pub. L. 101-508, Nov. 5, 1990, 104 Stat. 1388-400. Section 11801(a)(13) of the Act repealed section 188 of this title. For complete classification of this Act to the Code, see Short Title note set out under section 1 of this title and Tables.

AMENDMENTS

2006—Subsec. (a)(2)(C), (3)(C). Pub. L. 109-432 inserted “179E,” after “179D.”

2005—Subsec. (a)(2)(C). Pub. L. 109-135, §403(e)(2), (i)(2), inserted “181,” after “179B,” and substituted “193, or 194” for “or 193”.

Pub. L. 109-58, §1331(b)(2), inserted “179D,” after “179C.”

Pub. L. 109-58, §1323(b)(1), inserted “179C,” after “179B.”

Subsec. (a)(3)(C). Pub. L. 109-58, §1331(b)(2), inserted “179D,” after “179C.”

Pub. L. 109-58, §1323(b)(1), inserted “179C,” after “179B.”

Subsec. (b)(3). Pub. L. 109-135, §402(a)(6)(B), substituted “paragraph (6)” for “paragraph (7)”.

Subsec. (b)(5) to (8). Pub. L. 109-135, §402(a)(6)(A), redesignated pars. (6) to (9) as (5) to (8), respectively, and struck out heading and text of former par. (5). Text read as follows: “Under regulations prescribed by the Secretary, rules consistent with paragraphs (3) and (4) of this subsection shall apply in the case of transactions described in section 1081 (relating to exchanges in obedience to SEC orders).”

Subsec. (b)(9). Pub. L. 109-135, §402(a)(6)(A), redesignated par. (9) as (8).

Pub. L. 109-58, §1363(a), added par. (9).

2004—Subsec. (a)(2)(C), (3)(C). Pub. L. 108-357, §338(b)(5), inserted “179B,” after “179A.”

Subsec. (a)(4). Pub. L. 108-357, §886(b)(2), struck out par. (4) which related to special rule for player contracts if a franchise to conduct any sports enterprise is sold or exchanged.

1997—Subsec. (a)(2)(C), (3)(C). Pub. L. 105-34 inserted “179A,” after “179.”

1996—Subsec. (a)(3). Pub. L. 104-188 reenacted heading without change and amended introductory provisions generally. Prior to amendment, introductory provisions read as follows: “For purposes of this section, the term ‘section 1245 property’ means any property which is or has been property of a character subject to the allowance for depreciation provided in section 167 (or subject to the allowance of amortization provided in) and is either—”.

1995—Subsec. (b)(5). Pub. L. 104-7 struck out “1071 and” before “1081 transactions” in heading and “section 1071 (relating to gain from sale or exchange to effectuate policies of FCC) or” before “section 1081” in text.

1993—Subsec. (a)(2)(C). Pub. L. 103-66, §13261(f)(4), substituted “or 193” for “193, or 1253(d)(2) or (3)”.

Subsec. (a)(3). Pub. L. 103-66, §13261(f)(5), struck out “section 185 or 1253(d)(2) or (3)” after “amortization provided in” in introductory provisions.

1990—Subsec. (a)(3). Pub. L. 101-508, §11704(a)(13), substituted “or (3)” for “or (3)” in introductory provisions.

Subsec. (a)(3)(C). Pub. L. 101-508, §11801(c)(6)(E), substituted “188 (as in effect before its repeal by the Revenue Reconciliation Act of 1990),” for “188.”

Subsec. (a)(3)(D). Pub. L. 101-508, §11813(b)(21), substituted “section 168(i)(13)” for “section 48(p)”.

Subsec. (b)(3). Pub. L. 101-508, §11801(c)(8)(H), struck out “371(a), 374(a),” after “332, 351, 361.”

1989—Subsec. (a)(2)(C). Pub. L. 101-239, §7622(b)(2)(A)[(d)(2)(A)], substituted “193, or 1253(d)(2) or (3)” for “or 193”.

Subsec. (a)(3). Pub. L. 101-239, §7622(b)(2)(B)[(d)(2)(B)], substituted “section 185 or 1253(d)(2) or (3)” for “section 185” in introductory provisions.

1988—Subsec. (a)(3)(F). Pub. L. 100-647 added subpar. (F).

1986—Subsec. (a)(1). Pub. L. 99-514, §201(d)(11)(A), struck out “during a taxable year beginning after December 31, 1962, or section 1245 recovery property is disposed of after December 31, 1980,” after “if section 1245 property is disposed of”.

Subsec. (a)(2). Pub. L. 99-514, §201(d)(11)(B), amended par. (2) generally, restating former subpars. (A) to (E) and concluding provisions as subpars. (A) to (C).

Subsec. (a)(3). Pub. L. 99-514, §201(d)(11)(C), redesignated subpars. (D), (E), and (F) as (C), (D), and (E), respectively, and struck out former subpar. (C) which read as follows: “an elevator or an escalator”.

Subsec. (a)(5), (6). Pub. L. 99-514, §201(d)(11)(D), struck out par. (5) which defined “section 1245 recovery property” and par. (6) which provided special rule for qualified leased property.

1985—Subsec. (a)(5)(A) to (C). Pub. L. 99-121 substituted “19-year real property” for “18-year real property”.

1984—Subsec. (a)(5)(A) to (C). Pub. L. 98-369, § 111(e)(5), substituted “18-year real property and low-income housing” for “15-year real property”.

Subsec. (d)(5)(D). Pub. L. 98-369, § 111(e)(10), substituted “low-income housing (within the meaning of section 168(c)(2)(F))” for “15-year real property which is described in clause (i), (ii), (iii), or (iv) of section 1250(a)(1)(B)”.

1983—Subsec. (a)(3)(F). Pub. L. 97-448 inserted “(not including a building or its structural components)” after “a storage facility”.

1981—Subsec. (a)(1). Pub. L. 97-34, § 204(a), inserted reference to section 1245 recovery property disposed of after Dec. 31, 1980, in introductory provisions.

Subsec. (a)(2). Pub. L. 97-34, §§ 202(b)(1)–(3), 204(b), inserted reference to section 179 in subpar. (D), added subpar. (E), and, in provisions following subpar. (E), and inserted references to section 179 in three places. Pub. L. 97-34, § 212(d)(2)(F), in provisions following subpar. (E), substituted “191 (as in effect before its repeal by the Economic Recovery Tax Act of 1981)” for “191” in two places.

Subsec. (a)(3)(D). Pub. L. 97-34, § 202(b)(3), inserted reference to section 179.

Subsec. (a)(3)(E), (F). Pub. L. 97-34, § 201(b), added subpars. (E) and (F).

Subsec. (a)(5). Pub. L. 97-34, § 204(c), added par. (5).

Subsec. (a)(6). Pub. L. 97-34, § 204(d), added par. (6).

1980—Subsec. (a)(2). Pub. L. 96-451, § 301(c)(1)(A), (B), inserted references to section 194 in subpar. (D) and text following subpar. (D).

Pub. L. 96-223, § 251(a)(2)(C)(i)–(iii), inserted references to section 193 in subpar. (D) and text following subpar. (D).

Subsec. (a)(3)(D). Pub. L. 96-451, § 301(c)(1)(B), inserted reference to section 194.

Pub. L. 96-223, § 251(a)(2)(C)(i), inserted reference to section 193.

Subsec. (b)(8). Pub. L. 96-451, § 301(c)(1)(C), added par. (8).

1978—Subsec. (a)(2). Pub. L. 95-600, § 701(f)(3)(A), struck out from the listed sections in subpar. (D) reference to 191 and inserted “(in the case of property described in paragraph (3)(C))” before “191” in two places in next to last sentence.

Subsec. (a)(3)(D). Pub. L. 95-600, § 701(f)(3)(B), struck out reference to section 191.

Subsec. (a)(4)(B). Pub. L. 95-600, § 701(w)(2), inserted “attributable to periods after December 31, 1975,” after “for the depreciation”, “incurred after December 31, 1975,” after “allowable for losses”, and “described in clause (i)” after “of the amounts”.

Subsec. (a)(4)(C). Pub. L. 95-600, § 701(w)(1), struck out provisions relating to the aggregate of the amounts treated as ordinary income.

1976—Subsec. (a)(1). Pub. L. 94-455, § 1901(b)(3)(K), substituted “ordinary income” for “gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231”.

Subsec. (a)(2)(D). Pub. L. 94-455, §§ 2122(b)(3)(B), 2124(a)(2), inserted reference to sections 190 and 191.

Subsec. (a)(2) foll. (D). Pub. L. 94-455, §§ 1901(b)(11)(D), 1951(c)(2)(C), 2122(b)(3)(A), (C), 2124(a)(2), in text following subpar. (D): struck out reference to section 187 in two places; inserted “(as in effect before its repeal by the Tax Reform Act of 1976),” after “section 168,” in two places; inserted provision for treatment for purposes of this section of any deduction allowable under section 190 as if it were a deduction allowable for amortization; and inserted reference to section 191 in two places, respectively.

Subsec. (a)(3)(D). Pub. L. 94-455, §§ 2122(b)(3)(A), 2124(a)(2), inserted reference to sections 190 and 191.

Subsec. (a)(4). Pub. L. 94-455, § 212(b)(1), added par. (4).

Subsec. (b)(5). Pub. L. 94-455, § 1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

Subsec. (b)(7)(B). Pub. L. 94-455, § 1901(a)(140), struck out “such organization acquiring such property,” before “such organization”.

Subsec. (c). Pub. L. 94-455, § 1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

1975—Subsec. (b)(3), (7). Pub. L. 94-81, § 2(a)(1), (2), inserted reference to par. (7) in par. (3), and added par. (7).

1971—Subsec. (a)(2). Pub. L. 92-178, § 303(c)(1), inserted reference to section 188 in two places in text following subpar. (D).

Subsec. (a)(3)(B)(ii), (iii). Pub. L. 92-178, § 104(a)(2), substituted “research facility” for “research or storage facility” in cl. (ii) and added cl. (iii).

Subsec. (a)(3)(D). Pub. L. 92-178, § 303(c)(2), inserted reference to section 188.

1969—Subsec. (a)(2). Pub. L. 91-172, §§ 212(a)(1), 704(b)(4)(A), (B), added subpar. (C) and inserted references to sections 169, 185, and 187, and added subpar. (D).

Subsec. (a)(3). Pub. L. 91-172, §§ 212(a)(2), 704(b)(4)(C)–(F), struck out “(other than livestock)” after “means any property” and substituted “section 167 (or subject to the allowance of amortization provided in section 185)” for “section 167” and added subpar. (D).

1964—Subsec. (a)(2), (3)(C). Pub. L. 88-272 redefined “recomputed basis” with respect to elevators or escalators in par. (2), and inserted subpar. (C) in par. (3).

EFFECTIVE DATE OF 2006 AMENDMENT

Amendment by Pub. L. 109-432 applicable to costs paid or incurred after Dec. 20, 2006, see section 404(c) of Pub. L. 109-432, set out as an Effective Date note under section 179E of this title.

EFFECTIVE DATE OF 2005 AMENDMENTS

Amendment by section 402(a)(6) of Pub. L. 109-135 effective as if included in the provisions of the Energy Policy Act of 2005, Pub. L. 109-58, to which it relates, but not applicable with respect to any transaction ordered in compliance with the Public Utility Holding Company Act of 1935 (15 U.S.C. 79 et seq.) before its repeal, see section 402(m) of Pub. L. 109-135, set out as an Effective and Termination Dates of 2005 Amendments note under section 23 of this title.

Amendments by section 403(e)(2), (i)(2) of Pub. L. 109-135 effective as if included in the provisions of the American Jobs Creation Act of 2004, Pub. L. 108-357, to which they relate, see section 403(nn) of Pub. L. 109-135, set out as a note under section 26 of this title.

Amendment by section 1323(b)(1) of Pub. L. 109-58 applicable to properties placed in service after Aug. 8, 2005, see section 1323(c) of Pub. L. 109-58, set out as an Effective Date note under section 179C of this title.

Amendment by section 1331(b)(2) of Pub. L. 109-58 applicable to property placed in service after Dec. 31, 2005, see section 1331(d) of Pub. L. 109-58, set out as an Effective Date note under section 179D of this title.

Pub. L. 109-58, title XIII, § 1363(b), Aug. 8, 2005, 119 Stat. 1060, provided that: “The amendment made by this section [amending this section] shall apply to dispositions of property after the date of the enactment of this Act [Aug. 8, 2005].”

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by section 338(b)(5) of Pub. L. 108-357 applicable to expenses paid or incurred after Dec. 31, 2002, in taxable years ending after such date, see section 338(c) of Pub. L. 108-357, set out as an Effective Date note under section 179B of this title.

Amendment by section 886(b)(2) of Pub. L. 108-357 applicable to franchises acquired after Oct. 22, 2004, see section 886(c)(2) of Pub. L. 108-357, set out as a note under section 197 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 effective as if included in the amendments made by section 1913 of the Energy Policy Act of 1992, Pub. L. 102-486, see section 1604(a)(4) of Pub. L. 105-34, set out as a note under section 263 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 effective as if included in the provision of the Revenue Reconciliation Act of

1993, Pub. L. 103-66, §§ 13001-13444, to which such amendment relates, see section 1703(o) of Pub. L. 104-188, set out as a note under section 39 of this title.

EFFECTIVE DATE OF 1995 AMENDMENT

Amendment by Pub. L. 104-7 applicable to sales and exchanges on or after January 17, 1995, and to sales and exchanges before such date if FCC tax certificate with respect to such sale or exchange was issued on or after such date, but not applicable with respect to certain binding contracts, see section 2(d) of Pub. L. 104-7, set out as an Effective Date of Repeal note under section 1071 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103-66 applicable, except as otherwise provided, with respect to property acquired after Aug. 10, 1993, see section 13261(g) of Pub. L. 103-66, set out as an Effective Date note under section 197 of this title.

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by section 11813(b)(21) of Pub. L. 101-508 applicable to property placed in service after Dec. 31, 1990, but not applicable to any transition property (as defined in section 49(e) of this title), any property with respect to which qualified progress expenditures were previously taken into account under section 46(d) of this title, and any property described in section 46(b)(2)(C) of this title, as such sections were in effect on Nov. 4, 1990, see section 11813(c) of Pub. L. 101-508, set out as a note under section 45K of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101-239 applicable to transfers after Oct. 2, 1989, but not applicable to any transfer pursuant to a written binding contract in effect on Oct. 2, 1989, and at all times thereafter before the transfer, see section 7622(c)[(e)] of Pub. L. 101-239, set out as a note under section 167 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 applicable to property placed in service after Dec. 31, 1986, in taxable years ending after such date, with exceptions, see sections 203 and 204 of Pub. L. 99-514, set out as a note under section 168 of this title.

Amendment by Pub. L. 99-514 not applicable to any property placed in service before Jan. 1, 1994, if such property placed in service as part of specified rehabilitations, and not applicable to certain additional rehabilitations, see section 251(d)(2), (3) of Pub. L. 99-514, set out as a note under section 46 of this title.

EFFECTIVE DATE OF 1985 AMENDMENT

Amendment by Pub. L. 99-121 applicable with respect to property placed in service by the taxpayer after May 8, 1985, with specified exceptions, see section 105(b) of Pub. L. 99-121, set out as a note under section 168 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 applicable with respect to property placed in service by the taxpayer after Mar. 15, 1984, subject to certain exceptions, see section 111(g) of Pub. L. 98-369, set out as a note under section 168 of this title.

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by Pub. L. 97-448 effective, except as otherwise provided, as if it had been included in the

provision of the Economic Recovery Tax Act of 1981, Pub. L. 97-34, to which such amendment relates, see section 109 of Pub. L. 97-448, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1981 AMENDMENT

Amendment by sections 201(b), 202(b), and 204(a)-(d) of Pub. L. 97-34 applicable to property placed in service after Dec. 31, 1980, in taxable years ending after that date, see section 209(a) of Pub. L. 97-34, set out as an Effective Date note under section 168 of this title.

Amendment by section 212(d)(2)(F) of Pub. L. 97-34 applicable to expenditures incurred after Dec. 31, 1981, in taxable years ending after such date, see section 212(e) of Pub. L. 97-34, set out as a note under section 46 of this title.

EFFECTIVE DATE OF 1980 AMENDMENTS

Amendment by Pub. L. 96-451 applicable with respect to additions to capital account made after Dec. 31, 1979, see section 301(d) of Pub. L. 96-451, set out as an Effective Date note under section 194 of this title.

Amendment by Pub. L. 96-223 applicable to taxable years beginning after Dec. 31, 1979, see section 251(b) of Pub. L. 96-223, set out as an Effective Date note under section 193 of this title.

EFFECTIVE DATE OF 1978 AMENDMENT

Amendment by section 701(f)(3)(A), (B) of Pub. L. 95-600 effective as if included within the amendment of subsec. (a)(2), (3)(D) by section 2124 of Pub. L. 94-455, see section 701(f)(8) of Pub. L. 95-600, set out as an Effective and Termination Dates of 1978 Amendments note under section 167 of this title.

Section 701(w)(3) of Pub. L. 95-600 provided that: "The amendments made by this subsection [amending this section] shall apply to transfers of player contracts in connection with any sale or exchange of a franchise after December 31, 1975."

EFFECTIVE DATE OF 1976 AMENDMENT

Section 212(b)(2) of Pub. L. 94-455 provided that: "The amendment made by this subsection [amending this section] applies to transfers of player contracts in connection with any sale or exchange of a franchise after December 31, 1975."

Amendment by section 1901(a)(140), (b)(3)(K), (11)(D) of Pub. L. 94-455 effective for taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

Amendment by section 1951(c)(2)(C) of Pub. L. 94-455 applicable to taxable years beginning after Dec. 31, 1976, see section 1951(d) of Pub. L. 94-455, set out as a note under section 72 of this title.

Amendment by section 2122(b)(3) of Pub. L. 94-455 applicable to taxable years beginning after Dec. 31, 1976, see section 2122(c) of Pub. L. 94-455, as amended, set out as an Effective Date note under section 190 of this title.

Amendment by section 2124(a)(2) of Pub. L. 94-455 applicable with respect to additions to capital account made after June 14, 1976 and before June 15, 1981, see section 2124(a)(4) of Pub. L. 94-455, set out as an Effective Date note under section 642 of this title.

EFFECTIVE DATE OF 1975 AMENDMENT

Amendment by Pub. L. 94-81 applicable to dispositions after Dec. 31, 1969, in taxable years ending after such date, with special provision for an election in the case of dispositions occurring before Aug. 9, 1975, see section 2(c) of Pub. L. 94-81, set out as a note under section 1250 of this title.

EFFECTIVE DATE OF 1971 AMENDMENT

Amendment by section 104(a)(2) of Pub. L. 92-178 applicable to property described in section 50 of this title relating to restoration of credit, see section 104(h) of Pub. L. 92-178, set out as a note under section 48 of this title.

Amendment by section 303(c)(1), (2) of Pub. L. 92-178 applicable to taxable years ending after Dec. 31, 1971, see section 303(d) of Pub. L. 92-178, set out as a note under section 642 of this title.

EFFECTIVE DATE OF 1969 AMENDMENT

Section 212(a)(3) of Pub. L. 91-172 provided that: “The amendments made by paragraphs (1) and (2) [amending this section] shall apply with respect to taxable years beginning after December 31, 1969.”

Amendment by section 704(b)(4) of Pub. L. 91-172 applicable to taxable years ending after Dec. 31, 1968, see section 704(c) of Pub. L. 91-172, set out as a note under section 169 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Amendment by Pub. L. 88-272 applicable with respect to dispositions after Dec. 31, 1963, in taxable years ending after such date, see section 203(f)(3) of Pub. L. 88-272, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section 13(g) of Pub. L. 87-834 provided that: “The amendments made by this section [enacting this section and amending sections 167, 170, 301, 312, 341, 453, 613, and 751 of this title] (other than the amendments made by subsection (c) [amending sections 167, 179, and 642 of this title]) shall apply to taxable years beginning after December 31, 1962. The amendments made by subsection (c) shall apply to taxable years beginning after December 31, 1961, and ending after the date of the enactment of this Act [Oct. 16, 1962].”

SAVINGS PROVISION

For provisions that nothing in amendment by sections 11801 and 11813 of Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

[§§ 1246, 1247. Repealed. Pub. L. 108-357, title IV, § 413(a)(2), (3), Oct. 22, 2004, 118 Stat. 1506]

Section 1246, added Pub. L. 87-834, § 14(a)(1), Oct. 16, 1962, 76 Stat. 1036; amended Pub. L. 94-455, title XIV, § 1402(b)(1)(W), (2), title XIX, §§ 1901(a)(141), (b)(3)(I), (32)(B)(ii), 1906(b)(13)(A), title XX, § 2005(a)(5), Oct. 4, 1976, 90 Stat. 1732, 1787, 1793, 1800, 1834, 1877; Pub. L. 96-223, title IV, § 401(a), Apr. 2, 1980, 94 Stat. 299; Pub. L. 97-34, title VIII, § 832(a), Aug. 13, 1981, 95 Stat. 355; Pub. L. 98-369, div. A, title I, § 134(a), title X, § 1001(b)(20), (e), July 18, 1984, 98 Stat. 668, 1012; Pub. L. 99-514, title XII, § 1235(b), Oct. 22, 1986, 100 Stat. 2574; Pub. L. 100-647, title I, §§ 1012(p)(21), 1018(o)(2), Nov. 10, 1988, 102 Stat. 3519, 3585; Pub. L. 107-16, title V, § 542(e)(5)(A), June 7, 2001, 115 Stat. 85; Pub. L. 111-312, title III, § 301(a), Dec. 17, 2010, 124 Stat. 3300, related to treatment of gain on foreign investment company stock.

Section 1247, added Pub. L. 87-834, § 14(a)(1), Oct. 16, 1962, 76 Stat. 1037; amended Pub. L. 94-455, title XIV, § 1402(b)(1)(X), (2), title XIX, §§ 1901(b)(33)(P), (R), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1732, 1802, 1834; Pub. L. 98-369, div. A, title X, § 1001(b)(21), (e), July 18, 1984, 98 Stat. 1012, related to election by foreign investment companies to distribute income currently.

EFFECTIVE DATE OF REPEAL

Repeal applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108-357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

§ 1248. Gain from certain sales or exchanges of stock in certain foreign corporations

(a) General rule

If—

(1) a United States person sells or exchanges stock in a foreign corporation, and

(2) such person owns, within the meaning of section 958(a), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such foreign corporation was a controlled foreign corporation (as defined in section 957),

then the gain recognized on the sale or exchange of such stock shall be included in the gross income of such person as a dividend, to the extent of the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary) to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock sold or exchanged was held by such person while such foreign corporation was a controlled foreign corporation. For purposes of this section, a United States person shall be treated as having sold or exchanged any stock if, under any provision of this subtitle, such person is treated as realizing gain from the sale or exchange of such stock.

(b) Limitation on tax applicable to individuals

In the case of an individual, if the stock sold or exchanged is a capital asset (within the meaning of section 1221) and has been held for more than 1 year, the tax attributable to an amount included in gross income as a dividend under subsection (a) shall not be greater than a tax equal to the sum of—

(1) a pro rata share of the excess of—

(A) the taxes that would have been paid by the foreign corporation with respect to its income had it been taxed under this chapter as a domestic corporation (but without allowance for deduction of, or credit for, taxes described in subparagraph (B)), for the period or periods the stock sold or exchanged was held by the United States person in taxable years beginning after December 31, 1962, while the foreign corporation was a controlled foreign corporation, adjusted for distributions and amounts previously included in gross income of a United States shareholder under section 951, over

(B) the income, war profits, or excess profits taxes paid by the foreign corporation with respect to such income; and

(2) an amount equal to the tax that would result by including in gross income, as gain from the sale or exchange of a capital asset held for more than 1 year, an amount equal to the excess of (A) the amount included in gross income as a dividend under subsection (a), over (B) the amount determined under paragraph (1).

(c) Determination of earnings and profits**(1) In general**

Except as provided in section 312(k)(4), for purposes of this section, the earnings and profits of any foreign corporation for any taxable year shall be determined according to rules substantially similar to those applicable to domestic corporations, under regulations prescribed by the Secretary.

(2) Earnings and profits of subsidiaries of foreign corporations

If—

(A) subsection (a) or (f) applies to a sale, exchange, or distribution by a United States person of stock of a foreign corporation and, by reason of the ownership of the stock sold or exchanged, such person owned within the meaning of section 958(a)(2) stock of any other foreign corporation; and

(B) such person owned, within the meaning of section 958(a), or was considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such other foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such other foreign corporation was a controlled foreign corporation (as defined in section 957),

then, for purposes of this section, the earnings and profits of the foreign corporation the stock of which is sold or exchanged which are attributable to the stock sold or exchanged shall be deemed to include the earnings and profits of such other foreign corporation which—

(C) are attributable (under regulations prescribed by the Secretary) to the stock of such other foreign corporation which such person owned within the meaning of section 958(a)(2) (by reason of his ownership within the meaning of section 958(a)(1)(A) of the stock sold or exchanged) on the date of such sale or exchange (or on the date of any sale or exchange of the stock of such other foreign corporation occurring during the 5-year period ending on the date of the sale or exchange of the stock of such foreign corporation, to the extent not otherwise taken into account under this section but not in excess of the fair market value of the stock of such other foreign corporation sold or exchanged over the basis of such stock (for determining gain) in the hands of the transferor); and

(D) were accumulated in taxable years of such other corporation beginning after December 31, 1962, and during the period or periods—

(i) such other corporation was a controlled foreign corporation, and

(ii) such person owned within the meaning of section 958(a) the stock of such other foreign corporation.

(d) Exclusions from earnings and profits

For purposes of this section, the following amounts shall be excluded, with respect to any United States person, from the earnings and profits of a foreign corporation:

(1) Amounts included in gross income under section 951

Earnings and profits of the foreign corporation attributable to any amount previously included in the gross income of such person under section 951, with respect to the stock sold or exchanged, but only to the extent the inclusion of such amount did not result in an exclusion of an amount from gross income under section 959.

[2] Repealed. Pub. L. 100-647, title I, § 1006(e)(14)(A), Nov. 10, 1988, 102 Stat. 3402]

(3) Less developed country corporations under prior law

Earnings and profits of a foreign corporation which were accumulated during any taxable year beginning before January 1, 1976, while such corporation was a less developed country corporation under section 902(d) as in effect before the enactment of the Tax Reduction Act of 1975.

(4) United States income

Any item includible in gross income of the foreign corporation under this chapter—

(A) for any taxable year beginning before January 1, 1967, as income derived from sources within the United States of a foreign corporation engaged in trade or business within the United States, or

(B) for any taxable year beginning after December 31, 1966, as income effectively connected with the conduct by such corporation of a trade or business within the United States.

This paragraph shall not apply with respect to any item which is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States.

(5) Foreign trade income

Earnings and profits of the foreign corporation attributable to foreign trade income of a FSC (as defined in section 922) other than foreign trade income which—

(A) is section 923(a)(2) non-exempt income (within the meaning of section 927(d)(6)), or

(B) would not (but for section 923(a)(4)) be treated as exempt foreign trade income.

For purposes of the preceding sentence, the terms “foreign trade income” and “exempt foreign trade income” have the respective meanings given such terms by section 923. Any reference in this paragraph to section 922, 923, or 927 shall be treated as a reference to such section as in effect before its repeal by the FSC Repeal and Extraterritorial Income Exclusion Act of 2000.

(6) Amounts included in gross income under section 1293

Earnings and profits of the foreign corporation attributable to any amount previously included in the gross income of such person under section 1293 with respect to the stock sold or exchanged, but only to the extent the inclusion of such amount did not result in an exclusion of an amount under section 1293(c).

(e) Sales or exchanges of stock in certain domestic corporations

Except as provided in regulations prescribed by the Secretary, if—

(1) a United States person sells or exchanges stock of a domestic corporation, and

(2) such domestic corporation was formed or availed of principally for the holding, directly or indirectly, of stock of one or more foreign corporations,

such sale or exchange shall, for purposes of this section, be treated as a sale or exchange of the stock of the foreign corporation or corporations held by the domestic corporation.

(f) Certain nonrecognition transactions

Except as provided in regulations prescribed by the Secretary—

(1) In general

If—

(A) a domestic corporation satisfies the stock ownership requirements of subsection (a)(2) with respect to a foreign corporation, and

(B) such domestic corporation distributes stock of such foreign corporation in a distribution to which section 311(a), 337, 355(c)(1), or 361(c)(1) applies,

then, notwithstanding any other provision of this subtitle, an amount equal to the excess of the fair market value of such stock over its adjusted basis in the hands of the domestic corporation shall be included in the gross income of the domestic corporation as a dividend to the extent of the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary) to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock was held by such domestic corporation while such foreign corporation was a controlled foreign corporation. For purposes of subsections (c)(2), (d), and (h), a distribution of stock to which this subsection applies shall be treated as a sale of stock to which subsection (a) applies.

(2) Exception for certain distributions

In the case of any distribution of stock of a foreign corporation, paragraph (1) shall not apply if such distribution is to a domestic corporation—

(A) which is treated under this section as holding such stock for the period for which the stock was held by the distributing corporation, and

(B) which, immediately after the distribution, satisfies the stock ownership requirements of subsection (a)(2) with respect to such foreign corporation.

(3) Application to cases described in subsection (e)

To the extent that earnings and profits are taken into account under this subsection, they shall be excluded and not taken into account for purposes of subsection (e).

(g) Exceptions

This section shall not apply to—

(1) distributions to which section 303 (relating to distributions in redemption of stock to pay death taxes) applies; or

(2) any amount to the extent that such amount is, under any other provision of this title, treated as—

(A) a dividend (other than an amount treated as a dividend under subsection (f)),

(B) ordinary income, or

(C) gain from the sale of an asset held for not more than 1 year.

(h) Taxpayer to establish earnings and profits

Unless the taxpayer establishes the amount of the earnings and profits of the foreign corporation to be taken into account under subsection (a) or (f), all gain from the sale or exchange shall be considered a dividend under subsection (a) or (f), and unless the taxpayer establishes the amount of foreign taxes to be taken into account under subsection (b), the limitation of such subsection shall not apply.

(i) Treatment of certain indirect transfers**(1) In general**

If any shareholder of a 10-percent corporate shareholder of a foreign corporation exchanges stock of the 10-percent corporate shareholder for stock of the foreign corporation, such 10-percent corporate shareholder shall recognize gain in the same manner as if the stock of the foreign corporation received in such exchange had been—

(A) issued to the 10-percent corporate shareholder, and

(B) then distributed by the 10-percent corporate shareholder to such shareholder in redemption or liquidation (whichever is appropriate).

The amount of gain recognized by such 10-percent corporate shareholder under the preceding sentence shall not exceed the amount treated as a dividend under this section.

(2) 10-percent corporate shareholder defined

For purposes of this subsection, the term “10-percent corporate shareholder” means any domestic corporation which, as of the day before the exchange referred to in paragraph (1), satisfies the stock ownership requirements of subsection (a)(2) with respect to the foreign corporation.

(j) Cross reference

For provision excluding amounts previously taxed under this section from gross income when subsequently distributed, see section 959(e).

(Added Pub. L. 87-834, §15(a), Oct. 16, 1962, 76 Stat. 1041; amended Pub. L. 89-809, title I, §104(k), Nov. 13, 1966, 80 Stat. 1562; Pub. L. 91-172, title IV, §442(b)(2), Dec. 30, 1969, 83 Stat. 628; Pub. L. 94-455, title X, §§1022(a), 1042(b), (c)(1), (3), title XIV, §1402(b)(1)(Y), (2), title XIX, §§1901(b)(3)(H), (32)(B)(iii), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1619, 1636, 1637, 1732, 1793, 1800, 1834; Pub. L. 97-448, title I, §102(c)(1), Jan. 12, 1983, 96 Stat. 2370; Pub. L. 98-369, div. A, title I, §133(a), (b)(2), (c), title VIII, §801(d)(6), title X, §1001(b)(22), (e), July 18, 1984, 98 Stat. 667, 668, 996, 1012; Pub. L. 99-514, title VI, §631(d)(2), title XVIII, §§1810(i)(1), 1875(g)(1), 1876(a)(2), Oct. 22,

1986, 100 Stat. 2272, 2829, 2897; Pub. L. 100-647, title I, §§1006(e)(14), 1012(p)(19), Nov. 10, 1988, 102 Stat. 3402, 3518; Pub. L. 104-188, title I, §1702(g)(1), Aug. 20, 1996, 110 Stat. 1872; Pub. L. 108-357, title IV, §413(c)(22), Oct. 22, 2004, 118 Stat. 1509; Pub. L. 110-172, §11(g)(17), Dec. 29, 2007, 121 Stat. 2491.)

REFERENCES IN TEXT

The Tax Reduction Act of 1975, referred to in subsec. (d)(3), is Pub. L. 94-12, Mar. 29, 1975, 89 Stat. 26, as amended. For complete classification of this Act to the Code, see Short Title of 1975 Amendment note set out under section 1 of this title and Tables.

The FSC Repeal and Extraterritorial Income Exclusion Act of 2000, referred to in subsec. (d)(5), is Pub. L. 106-519, Nov. 15, 2000, 114 Stat. 2423. For complete classification of this Act to the Code, see Short Title of 2000 Amendments note set out under section 1 of this title and Tables.

AMENDMENTS

2007—Subsec. (d)(5). Pub. L. 110-172 inserted “(as defined in section 922)” after “a FSC” in introductory provisions and inserted second sentence in concluding provisions.

2004—Subsec. (d)(5) to (7). Pub. L. 108-357 redesignated pars. (6) and (7) as (5) and (6), respectively, and struck out heading and text of former par. (5). Text read as follows: “If the United States person whose stock is sold or exchanged was a qualified shareholder (as defined in section 1247(c)) of a foreign corporation which was a foreign investment company (as described in section 1246(b)(1)), the earnings and profits of the foreign corporation for taxable years in which such person was a qualified shareholder.”

1996—Subsec. (a). Pub. L. 104-188, §1702(g)(1)(A)(ii), in closing provisions inserted at end “For purposes of this section, a United States person shall be treated as having sold or exchanged any stock if, under any provision of this subtitle, such person is treated as realizing gain from the sale or exchange of such stock.”

Subsec. (a)(1). Pub. L. 104-188, §1702(g)(1)(A)(i), struck out “, or if a United States person receives a distribution from a foreign corporation which, under section 302 or 331, is treated as an exchange of stock” after “in a foreign corporation”.

Subsec. (e)(1). Pub. L. 104-188, §1702(g)(1)(B), struck out “, or receives a distribution from a domestic corporation which, under section 302 or 331, is treated as an exchange of stock” after “of a domestic corporation”.

Subsec. (f)(1)(B). Pub. L. 104-188, §1702(g)(1)(C), substituted “355(c)(1), or 361(c)(1)” for “or 361(c)(1)”.

Subsec. (i)(1). Pub. L. 104-188, §1702(g)(1)(D), reenacted heading without change and amended text generally. Prior to amendment, text read as follows: “If any shareholder of a 10-percent corporate shareholder of a foreign corporation exchanges stock of the 10-percent corporate shareholder for stock of the foreign corporation, for purposes of this section, the stock of the foreign corporation received in such exchange shall be treated as if it had been—

“(A) issued to the 10-percent corporate shareholder, and

“(B) then distributed by the 10-percent corporate shareholder to such shareholder in redemption or liquidation (whichever is appropriate).”

1988—Subsec. (d)(2). Pub. L. 100-647, §1006(e)(14)(A), struck out par. (2) which related to gain realized from sale or exchange of property in pursuance of plan of complete liquidation.

Subsec. (d)(7). Pub. L. 100-647, §1012(p)(19), added par. (7).

Subsec. (f). Pub. L. 100-647, §1006(e)(14)(E), substituted “nonrecognition” for “section 311, 336, or 337” in heading.

Subsec. (f)(1). Pub. L. 100-647, §1006(e)(14)(C), struck out “, sale, or exchange” after “(h), a distribution” in last sentence.

Subsec. (f)(1)(B). Pub. L. 100-647, §1006(e)(14)(B), amended subpar. (B) generally. Prior to amendment, subpar. (B) read as follows: “such domestic corporation distributes, sells, or exchanges stock of such foreign corporation in a transaction to which section 311, 336, or 337 applies.”

Subsec. (f)(3), (4). Pub. L. 100-647, §1006(e)(14)(D), redesignated par. (4) as (3) and struck out former par. (3) which related to nonapplication of paragraph (1) in certain cases.

1986—Subsec. (d)(6). Pub. L. 99-514, §1876(a)(2), amended par. (6) generally. Prior to amendment, par. (6) read as follows: “Earnings and profits of the foreign corporation attributable to foreign trade income (within the meaning of section 923(b)) of a FSC.”

Subsec. (e). Pub. L. 99-514, §631(d)(2)(A), substituted “Except as provided in regulations” for “Under regulations”.

Subsec. (f). Pub. L. 99-514, §631(d)(2)(B), inserted “Except as provided in regulations prescribed by the Secretary” after heading.

Subsec. (g). Pub. L. 99-514, §1875(g)(1), inserted “or” at end of par. (1), redesignated par. (3) as (2), and struck out former par. (2) which read as follows: “gain realized on exchanges to which section 356 (relating to receipt of additional consideration in certain reorganizations) applies; or”.

Subsec. (i)(1)(B). Pub. L. 99-514, §1810(i)(1), substituted “in redemption or liquidation (whichever is appropriate)” for “in redemption of his stock”.

1984—Subsec. (b). Pub. L. 98-369, §1001(b)(22), (e), substituted “6 months” for “1 year”, applicable to property acquired after June 22, 1984, and before Jan. 1, 1988. See Effective Date of 1984 Amendment note below.

Subsec. (c)(2)(D). Pub. L. 98-369, §133(c), substituted “section 958(a)” for “section 958(a)(2)”.

Subsec. (d)(6). Pub. L. 98-369, §801(d)(6), added par. (6).

Subsec. (g)(3)(C). Pub. L. 98-369, §1001(b)(22), (e), substituted “6 months” for “1 year”, applicable to property acquired after June 22, 1984, and before Jan. 1, 1988. See Effective Date of 1984 Amendment note below.

Subsec. (i). Pub. L. 98-369, §133(a), added subsec. (i).

Subsec. (j). Pub. L. 98-369, §133(b)(2), added subsec. (j).

1983—Subsec. (c)(1). Pub. L. 97-448 substituted “section 312(k)(4)” for “section 312(k)(3)”.

1976—Subsec. (a). Pub. L. 94-455, §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

Subsec. (b). Pub. L. 94-455, §1402(b)(2), provided that “9 months” would be changed to “1 year”.

Pub. L. 94-455, §1402(b)(1)(Y), provided that “6 months” would be changed to “9 months” for taxable years beginning in 1977.

Subsec. (c)(1). Pub. L. 94-455, §§1901(b)(32)(B)(iii), 1906(b)(13)(A), substituted “section 312(k)” for “section 312(m)(3)”, and struck out “or his delegate” after “Secretary”.

Subsec. (c)(2)(A). Pub. L. 94-455, §1042(c)(3)(A), substituted “subsection (a) or (f) applies to a sale, exchange, or distribution” for “subsection (a) applies to a sale or exchange”.

Subsec. (c)(2)(C). Pub. L. 94-455, §1042(b), inserted “(or on the date of any sale or exchange of the stock of such other foreign corporation occurring during the 5-year period ending on the date of the sale or exchange of the stock of such foreign corporation, to the extent not otherwise taken into account under this section but not in excess of the fair market value of the stock of such other foreign corporation sold or exchanged over the basis of such stock (for determining gain) in the hands of the transferor)”. §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

Subsec. (d)(2). Pub. L. 94-455, §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

Subsec. (d)(3). Pub. L. 94-455, §1022(a), substituted provisions of par. (3) relating to “Less developed country corporations under prior law” and reading “Earnings and profits of a foreign corporation which were accumulated during any taxable year beginning before January 1, 1976, while such corporation was a less developed country corporation under section 902(d) as in

effect before the enactment of the Tax Reduction Act of 1975" for prior par. (3) relating to "Less developed country corporations" and reading "Earnings and profits accumulated by a foreign corporation while it was a less developed country corporation (as defined in section 902(d)), if the stock sold or exchanged was owned for a continuous period of at least 10 years, ending with the date of the sale or exchange, by the United States person who sold or exchanged such stock. In the case of stock sold or exchanged by a corporation, if United States persons who are individuals, estates, or trusts (each of whom owned within the meaning of section 958(a), or were considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such corporation) owned, or were considered as owning, at any time during the 10-year period ending on the date of the sale or exchange more than 50 percent of the total combined voting power of all classes of stock entitled to vote such corporation, this paragraph shall apply only if such United States persons owned, or were considered as owning, at all times during the remainder of such 10-year period more than 50 percent of the total combined voting power of all classes of stock entitled to vote of such corporation. For purposes of this paragraph, stock owned by a United States person who is an individual, estate, or trust which was acquired by reason of the death of the predecessor in interest of such United States person shall be considered as owned by such United States person during the period such stock was owned by such predecessor in interest, and during the period such stock was owned by any other predecessor in interest if between such United States person and such other predecessor in interest there was no transfer other than by reason of the death of an individual."

Subsec. (e). Pub. L. 94-455, §1906(b)(13)(A), struck out "or his delegate" after "Secretary".

Subsec. (f). Pub. L. 94-455, §1042(c)(1), added subsec. (f). Former subsec. (f) redesignated (g).

Subsec. (g). Pub. L. 94-455, §§1042(c)(1), (3)(B), 1901(b)(3)(H), redesignated former subsec. (f) as (g); inserted "(other than an amount treated as a dividend under subsection (f))" in par. (3)(A); and substituted in par. (3)(B) "ordinary income" for "gain from the sale of an asset which is not a capital asset", respectively. Former subsec. (g) redesignated (h).

Subsec. (g)(3)(C). Pub. L. 94-455, §1402(b)(2), provided that "9 months" would be changed to "1 year".

Pub. L. 94-455, §1402(b)(1)(Y), provided that "6 months" would be changed to "9 months" for taxable years beginning in 1977.

Subsec. (h). Pub. L. 94-455, §1042(c)(1), (3)(C), redesignated former subsec. (g) as (h) and inserted reference to subsec. (f) in two places.

1969—Subsec. (c)(1). Pub. L. 91-172 inserted reference to the exception provided for in section 312(m)(3).

1966—Subsec. (d)(4). Pub. L. 89-809 provided that for taxable years beginning after December 31, 1966, the earnings and profits of the foreign corporation, for purposes of this section, is not to include income effectively connected with the conduct of a trade or business within the United States, and inserted provision that the exclusion does not apply to income which is exempt from tax or subject to a reduced rate of tax pursuant to a treaty.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108-357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 effective, except as otherwise expressly provided, as if included in the pro-

vision of the Revenue Reconciliation Act of 1990, Pub. L. 101-508, title XI, to which such amendment relates, see section 1702(i) of Pub. L. 104-188, set out as a note under section 38 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 631(d)(2) of Pub. L. 99-514 applicable to any distribution in complete liquidation, and any sale or exchange, made by a corporation after July 31, 1986, unless such corporation is completely liquidated before Jan. 1, 1987, any transaction described in section 338 of this title for which the acquisition date occurs after Dec. 31, 1986, and any distribution, not in complete liquidation, made after Dec. 31, 1986, with exceptions and special and transitional rules, see section 633 of Pub. L. 99-514, set out as an Effective Date note under section 336 of this title.

Section 1875(g)(2) of Pub. L. 99-514 provided that: "The amendment made by paragraph (1) [amending this section] shall apply to exchanges after March 1, 1986."

Amendment by sections 1810(i)(1) and 1876(a)(2) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Section 133(d)(1) of Pub. L. 98-369 provided that: "The amendment made by subsection (a) [amending this section] shall apply to exchanges after the date of the enactment of this Act [July 18, 1984] in taxable years ending after such date."

Amendment by section 133(b)(2), (c) of Pub. L. 98-369 applicable with respect to transactions to which subsec. (a) or (f) of this section applies occurring after July 18, 1984, with election of earlier date for certain transactions, see section 133(d)(2), (3) of Pub. L. 98-369, set out as a note under section 959 of this title.

Amendment by section 801(d)(6) of Pub. L. 98-369 applicable to transactions after Dec. 31, 1984, in taxable years ending after such date, see section 805(a)(1) of Pub. L. 98-369, as amended, set out as a note under section 245 of this title.

Amendment by section 1001(b)(22) of Pub. L. 98-369 applicable to property acquired after June 22, 1984, and before Jan. 1, 1988, see section 1001(e) of Pub. L. 98-369, set out as a note under section 166 of this title.

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by Pub. L. 97-448 effective, except as otherwise provided, as if it had been included in the provision of the Economic Recovery Tax Act of 1981, Pub. L. 97-34, to which such amendment relates, see section 109 of Pub. L. 97-448, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Section 1022(b) of Pub. L. 94-455 provided that: "The amendment made by subsection (a) [amending this section] shall apply to taxable years beginning after December 31, 1975."

For effective date of amendment by section 1042 of Pub. L. 94-455, see section 1042(e) of Pub. L. 94-455, set out as a note under section 367 of this title.

Section 1402(b)(1) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning in 1977.

Section 1402(b)(2) of Pub. L. 94-455 provided that the amendment made by that section is effective with respect to taxable years beginning after Dec. 31, 1977.

Amendment by section 1901(b)(3)(H), (32)(B)(iii) of Pub. L. 94-455 effective for taxable years beginning

after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment by Pub. L. 89-809 applicable with respect to sales or exchanges occurring after Dec. 31, 1966, see section 104(n) of Pub. L. 89-809, set out as a note under section 11 of this title.

EFFECTIVE DATE

Section 15(c) of Pub. L. 87-834 provided that: "The amendments made by this section [enacting this section] shall apply with respect to sales or exchanges occurring after December 31, 1962."

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

TRANSITIONAL RULE

Section 1875(g)(3) of Pub. L. 99-514 provided that: "An exchange shall be treated as occurring on or before March 1, 1986, if—

"(A) on or before such date, the taxpayer adopts a plan of reorganization to which section 356 [of the Internal Revenue Code of 1986] applies, and

"(B) such plan or reorganization is implemented and distributions pursuant to such plan are completed on or before the date of enactment of this Act [Oct. 22, 1986]."

§ 1249. Gain from certain sales or exchanges of patents, etc., to foreign corporations

(a) General rule

Gain from the sale or exchange after December 31, 1962, of a patent, an invention, model, or design (whether or not patented), a copyright, a secret formula or process, or any other similar property right to any foreign corporation by any United States person (as defined in section 7701(a)(30)) which controls such foreign corporation shall, if such gain would (but for the provisions of this subsection) be gain from the sale or exchange of a capital asset or of property described in section 1231, be considered as ordinary income.

(b) Control

For purposes of subsection (a), control means, with respect to any foreign corporation, the ownership, directly or indirectly, of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote. For purposes of this subsection, the rules for determining ownership of stock prescribed by section 958 shall apply.

(Added Pub. L. 87-834, §16(a), Oct. 16, 1962, 76 Stat. 1045; amended Pub. L. 89-809, title I, §104(m)(3), Nov. 13, 1966, 80 Stat. 1563; Pub. L. 94-455, title XIX, §1901(b)(3)(K), Oct. 4, 1976, 90 Stat. 1793.)

AMENDMENTS

1976—Subsec. (a). Pub. L. 94-455 substituted "ordinary income" for "gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231".

1966—Subsec. (a). Pub. L. 89-809 substituted "Gain" for "Except as provided in subsection (c), gain".

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by Pub. L. 94-455 effective for taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

EFFECTIVE DATE OF 1966 AMENDMENT

Amendment by Pub. L. 89-809 applicable with respect to taxable years beginning after Dec. 31, 1966, see section 104(n) of Pub. L. 89-809, set out as a note under section 11 of this title.

EFFECTIVE DATE

Section 16(c) of Pub. L. 87-834 provided that: "The amendments made by this section [enacting this section] shall apply to taxable years beginning after December 31, 1962."

§ 1250. Gain from dispositions of certain depreciable realty

(a) General rule

Except as otherwise provided in this section—

(1) Additional depreciation after December 31, 1975

(A) In general

If section 1250 property is disposed of after December 31, 1975, then the applicable percentage of the lower of—

(i) that portion of the additional depreciation (as defined in subsection (b)(1) or (4)) attributable to periods after December 31, 1975, in respect of the property, or

(ii) the excess of the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of such property (in the case of any other disposition), over the adjusted basis of such property,

shall be treated as gain which is ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(B) Applicable percentage

For purposes of subparagraph (A), the term "applicable percentage" means—

(i) in the case of section 1250 property with respect to which a mortgage is insured under section 221(d)(3) or 236 of the National Housing Act, or housing financed or assisted by direct loan or tax abatement under similar provisions of State or local laws and with respect to which the owner is subject to the restrictions described in section 1039(b)(1)(B) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990), 100 percent minus 1 percentage point for each full month the property was held after the date the property was held 100 full months;

(ii) in the case of dwelling units which, on the average, were held for occupancy by families or individuals eligible to receive subsidies under section 8 of the United States Housing Act of 1937, as amended, or under the provisions of State or local law authorizing similar levels of subsidy for lower-income families, 100 percent minus 1

percentage point for each full month the property was held after the date the property was held 100 full months;

(iii) in the case of section 1250 property with respect to which a depreciation deduction for rehabilitation expenditures was allowed under section 167(k), 100 percent minus 1 percentage point for each full month in excess of 100 full months after the date on which such property was placed in service;

(iv) in the case of section 1250 property with respect to which a loan is made or insured under title V of the Housing Act of 1949, 100 percent minus 1 percentage point for each full month the property was held after the date the property was held 100 full months; and

(v) in the case of all other section 1250 property, 100 percent.

In the case of a building (or a portion of a building devoted to dwelling units), if, on the average, 85 percent or more of the dwelling units contained in such building (or portion thereof) are units described in clause (ii), such building (or portion thereof) shall be treated as property described in clause (ii). Clauses (i), (ii), and (iv) shall not apply with respect to the additional depreciation described in subsection (b)(4) which was allowed under section 167(k).

(2) Additional depreciation after December 31, 1969, and before January 1, 1976

(A) In general

If section 1250 property is disposed of after December 31, 1969, and the amount determined under paragraph (1)(A)(ii) exceeds the amount determined under paragraph (1)(A)(i), then the applicable percentage of the lower of—

(i) that portion of the additional depreciation attributable to periods after December 31, 1969, and before January 1, 1976, in respect of the property, or

(ii) the excess of the amount determined under paragraph (1)(A)(ii) over the amount determined under paragraph (1)(A)(i),

shall also be treated as gain which is ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(B) Applicable percentage

For purposes of subparagraph (A), the term “applicable percentage” means—

(i) in the case of section 1250 property disposed of pursuant to a written contract which was, on July 24, 1969, and at all times thereafter, binding on the owner of the property, 100 percent minus 1 percentage point for each full month the property was held after the date the property was held 20 full months;

(ii) in the case of section 1250 property with respect to which a mortgage is insured under section 221(d)(3) or 236 of the National Housing Act, or housing financed or assisted by direct loan or tax abatement under similar provisions of State or local

laws, and with respect to which the owner is subject to the restrictions described in section 1039(b)(1)(B) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990), 100 percent minus 1 percentage point for each full month the property was held after the date the property was held 20 full months;

(iii) in the case of residential rental property (as defined in section 167(j)(2)(B)) other than that covered by clauses (i) and (ii), 100 percent minus 1 percentage point for each full month the property was held after the date the property was held 100 full months;

(iv) in the case of section 1250 property with respect to which a depreciation deduction for rehabilitation expenditures was allowed under section 167(k), 100 percent minus 1 percentage point for each full month in excess of 100 full months after the date on which such property was placed in service; and

(v) in the case of all other section 1250 property, 100 percent.

Clauses (i), (ii), and (iii) shall not apply with respect to the additional depreciation described in subsection (b)(4).

(3) Additional depreciation before January 1, 1970

(A) In general

If section 1250 property is disposed of after December 31, 1963, and the amount determined under paragraph (1)(A)(ii) exceeds the sum of the amounts determined under paragraphs (1)(A)(i) and (2)(A)(i), then the applicable percentage of the lower of—

(i) that portion of the additional depreciation attributable to periods before January 1, 1970, in respect of the property, or

(ii) the excess of the amount determined under paragraph (1)(A)(ii) over the sum of the amounts determined under paragraphs (1)(A)(i) and (2)(A)(i),

shall also be treated as gain which is ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(B) Applicable percentage

For purposes of subparagraph (A), the term “applicable percentage” means 100 percent minus 1 percentage point for each full month the property was held after the date on which the property was held for 20 full months.

(4) Special rule

For purposes of this subsection, any reference to section 167(k) or 167(j)(2)(B) shall be treated as a reference to such section as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990.

(5) Cross reference

For reduction in the case of corporations on capital gain treatment under this section, see section 291(a)(1).

(b) Additional depreciation defined

For purposes of this section—

(1) In general

The term “additional depreciation” means, in the case of any property, the depreciation adjustments in respect of such property; except that, in the case of property held more than one year, it means such adjustments only to the extent that they exceed the amount of the depreciation adjustments which would have resulted if such adjustments had been determined for each taxable year under the straight line method of adjustment.

(2) Property held by lessee

In the case of a lessee, in determining the depreciation adjustments which would have resulted in respect of any building erected (or other improvement made) on the leased property, or in respect of any cost of acquiring the lease, the lease period shall be treated as including all renewal periods. For purposes of the preceding sentence—

(A) the term “renewal period” means any period for which the lease may be renewed, extended, or continued pursuant to an option exercisable by the lessee, but

(B) the inclusion of renewal periods shall not extend the period taken into account by more than $\frac{2}{3}$ of the period on the basis of which the depreciation adjustments were allowed.

(3) Depreciation adjustments

The term “depreciation adjustments” means, in respect of any property, all adjustments attributable to periods after December 31, 1963, reflected in the adjusted basis of such property on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for exhaustion, wear and tear, obsolescence, or amortization (other than amortization under section 168 (as in effect before its repeal by the Tax Reform Act of 1976), 169, 185 (as in effect before its repeal by the Tax Reform Act of 1986), 188 (as in effect before its repeal by the Revenue Reconciliation Act of 1990), 190, or 193). For purposes of the preceding sentence, if the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed as a deduction for any period was less than the amount allowable, the amount taken into account for such period shall be the amount allowed.

(4) Additional depreciation attributable to rehabilitation expenditures

The term “additional depreciation” also means, in the case of section 1250 property with respect to which a depreciation or amortization deduction for rehabilitation expenditures was allowed under section 167(k) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) or 191 (as in effect before its repeal by the Economic Recovery Tax Act of 1981), the depreciation or amortization adjustments allowed under such section to the extent attributable to such property, except that, in the case of such property held for more than one year after the rehabilitation expenditures so allowed were incurred, it means such adjustments only to the extent that they exceed the

amount of the depreciation adjustments which would have resulted if such adjustments had been determined under the straight line method of adjustment without regard to the useful life permitted under section 167(k) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) or 191 (as in effect before its repeal by the Economic Recovery Tax Act of 1981).

(5) Method of computing straight line adjustments

For purposes of paragraph (1), the depreciation adjustments which would have resulted for any taxable year under the straight line method shall be determined—

(A) in the case of property to which section 168 applies, by determining the adjustments which would have resulted for such year if the taxpayer had elected the straight line method for such year using the recovery period applicable to such property, and

(B) in the case any property to which section 168 does not apply, if a useful life (or salvage value) was used in determining the amount allowable as a deduction for any taxable year, by using such life (or value).

(c) Section 1250 property

For purposes of this section, the term “section 1250 property” means any real property (other than section 1245 property, as defined in section 1245(a)(3)) which is or has been property of a character subject to the allowance for depreciation provided in section 167.

(d) Exceptions and limitations**(1) Gifts**

Subsection (a) shall not apply to a disposition by gift.

(2) Transfers at death

Except as provided in section 691 (relating to income in respect of a decedent), subsection (a) shall not apply to a transfer at death.

(3) Certain tax-free transactions

If the basis of property in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 721, or 731, then the amount of gain taken into account by the transferor under subsection (a) shall not exceed the amount of gain recognized to the transferor on the transfer of such property (determined without regard to this section). Except as provided in paragraph (9), this paragraph shall not apply to a disposition to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter.

(4) Like kind exchanges; involuntary conversions, etc.**(A) Recognition limit**

If property is disposed of and gain (determined without regard to this section) is not recognized in whole or in part under section 1031 or 1033, then the amount of gain taken into account by the transferor under subsection (a) shall not exceed the greater of the following:

(i) the amount of gain recognized on the disposition (determined without regard to this section), increased as provided in subparagraph (B), or

(ii) the amount determined under subparagraph (C).

(B) Increase for certain stock

With respect to any transaction, the increase provided by this subparagraph is the amount equal to the fair market value of any stock purchased in a corporation which (but for this paragraph) would result in non-recognition of gain under section 1033(a)(2)(A).

(C) Adjustment where insufficient section 1250 property is acquired

With respect to any transaction, the amount determined under this subparagraph shall be the excess of—

(i) the amount of gain which would (but for this paragraph) be taken into account under subsection (a), over

(ii) the fair market value (or cost in the case of a transaction described in section 1033(a)(2)) of the section 1250 property acquired in the transaction.

(D) Basis of property acquired

In the case of property purchased by the taxpayer in a transaction described in section 1033(a)(2), in applying section 1033(b)(2), such sentence shall be applied—

(i) first solely to section 1250 properties and to the amount of gain not taken into account under subsection (a) by reason of this paragraph, and

(ii) then to all purchased properties to which such sentence applies and to the remaining gain not recognized on the transaction as if the cost of the section 1250 properties were the basis of such properties computed under clause (i).

In the case of property acquired in any other transaction to which this paragraph applies, rules consistent with the preceding sentence shall be applied under regulations prescribed by the Secretary.

(E) Additional depreciation with respect to property disposed of

In the case of any transaction described in section 1031 or 1033, the additional depreciation in respect of the section 1250 property acquired which is attributable to the section 1250 property disposed of shall be an amount equal to the amount of the gain which was not taken into account under subsection (a) by reason of the application of this paragraph.

(5) Property distributed by a partnership to a partner

(A) In general

For purposes of this section, the basis of section 1250 property distributed by a partnership to a partner shall be deemed to be determined by reference to the adjusted basis of such property to the partnership.

(B) Additional depreciation

In respect of any property described in subparagraph (A), the additional deprecia-

tion attributable to periods before the distribution by the partnership shall be—

(i) the amount of the gain to which subsection (a) would have applied if such property had been sold by the partnership immediately before the distribution at its fair market value at such time and the applicable percentage for the property had been 100 percent, reduced by

(ii) if section 751(b) applied to any part of such gain, the amount of such gain to which section 751(b) would have applied if the applicable percentage for the property had been 100 percent.

(6) Transfers to tax-exempt organization where property will be used in unrelated business

(A) In general

The second sentence of paragraph (3) shall not apply to a disposition of section 1250 property to an organization described in section 511(a)(2) or 511(b)(2) if, immediately after such disposition, such organization uses such property in an unrelated trade or business (as defined in section 513).

(B) Later change in use

If any property with respect to the disposition of which gain is not recognized by reason of subparagraph (A) ceases to be used in an unrelated trade or business of the organization acquiring such property, such organization shall be treated for purposes of this section as having disposed of such property on the date of such cessation.

(7) Foreclosure dispositions

If any section 1250 property is disposed of by the taxpayer pursuant to a bid for such property at foreclosure or by operation of an agreement or of process of law after there was a default on indebtedness which such property secured, the applicable percentage referred to in paragraph (1)(B), (2)(B), or (3)(B) of subsection (a), as the case may be, shall be determined as if the taxpayer ceased to hold such property on the date of the beginning of the proceedings pursuant to which the disposition occurred, or, in the event there are no proceedings, such percentage shall be determined as if the taxpayer ceased to hold such property on the date, determined under regulations prescribed by the Secretary, on which such operation of an agreement or process of law, pursuant to which the disposition occurred, began.

(e) Holding period

For purposes of determining the applicable percentage under this section, the provisions of section 1223 shall not apply, and the holding period of section 1250 property shall be determined under the following rules:

(1) Beginning of holding period

The holding period of section 1250 property shall be deemed to begin—

(A) in the case of property acquired by the taxpayer, on the day after the date of acquisition, or

(B) in the case of property constructed, reconstructed, or erected by the taxpayer, on the first day of the month during which the property is placed in service.

(2) Property with transferred basis

If the basis of property acquired in a transaction described in paragraph (1), (2), or (3) of subsection (d) is determined by reference to its basis in the hands of the transferor, then the holding period of the property in the hands of the transferee shall include the holding period of the property in the hands of the transferor.

(f) Special rules for property which is substantially improved**(1) Amount treated as ordinary income**

If, in the case of a disposition of section 1250 property, the property is treated as consisting of more than one element by reason of paragraph (3), then the amount taken into account under subsection (a) in respect of such section 1250 property as ordinary income shall be the sum of the amounts determined under paragraph (2).

(2) Ordinary income attributable to an element

For purposes of paragraph (1), the amount taken into account for any element shall be the sum of a series of amounts determined for the periods set forth in subsection (a), with the amount for any such period being determined by multiplying—

(A) the amount which bears the same ratio to the lower of the amounts specified in clause (i) or (ii) of subsection (a)(1)(A), in clause (i) or (ii) of subsection (a)(2)(A), or in clause (i) or (ii) of subsection (a)(3)(A), as the case may be, for the section 1250 property as the additional depreciation for such element attributable to such period bears to the sum of the additional depreciation for all elements attributable to such period, by

(B) the applicable percentage for such element for such period.

For purposes of this paragraph, determinations with respect to any element shall be made as if it were a separate property.

(3) Property consisting of more than one element

In applying this subsection in the case of any section 1250 property, there shall be treated as a separate element—

(A) each separate improvement,

(B) if, before completion of section 1250 property, units thereof (as distinguished from improvements) were placed in service, each such unit of section 1250 property, and

(C) the remaining property which is not taken into account under subparagraphs (A) and (B).

(4) Property which is substantially improved

For purposes of this subsection—

(A) In general

The term “separate improvement” means each improvement added during the 36-month period ending on the last day of any taxable year to the capital account for the property, but only if the sum of the amounts added to such account during such period exceeds the greatest of—

(i) 25 percent of the adjusted basis of the property,

(ii) 10 percent of the adjusted basis of the property, determined without regard to

the adjustments provided in paragraphs (2) and (3) of section 1016(a), or

(iii) \$5,000.

For purposes of clauses (i) and (ii), the adjusted basis of the property shall be determined as of the beginning of the first day of such 36-month period, or of the holding period of the property (within the meaning of subsection (e)), whichever is the later.

(B) Exception

Improvements in any taxable year shall be taken into account for purposes of subparagraph (A) only if the sum of the amounts added to the capital account for the property for such taxable year exceeds the greater of—

(i) \$2,000, or

(ii) one percent of the adjusted basis referred to in subparagraph (A)(ii), determined, however, as of the beginning of such taxable year.

For purposes of this section, if the amount added to the capital account for any separate improvement does not exceed the greater of clause (i) or (ii), such improvement shall be treated as placed in service on the first day, of a calendar month, which is closest to the middle of the taxable year.

(C) Improvement

The term “improvement” means, in the case of any section 1250 property, any addition to capital account for such property after the initial acquisition or after completion of the property.

(g) Adjustments to basis

The Secretary shall prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain recognized under subsection (a).

(h) Application of section

This section shall apply notwithstanding any other provision of this subtitle.

(Added Pub. L. 88-272, title II, §231(a), Feb. 26, 1964, 78 Stat. 100; amended Pub. L. 91-172, title V, §521(b), (c), (e), title VII, §704(b)(5), title IX, §910(b), Dec. 30, 1969, 83 Stat. 652, 653, 670, 720; Pub. L. 92-178, title III, §303(c)(3), Dec. 10, 1971, 85 Stat. 522; Pub. L. 93-625, §5(c), Jan. 3, 1975, 88 Stat. 2112; Pub. L. 94-81, §2(b), Aug. 9, 1975, 89 Stat. 417; Pub. L. 94-455, title II, §202(a)-(c)(1), (2), title XIX, §§1901(b)(3)(K), (31)(A), (B), (E), 1906(b)(13)(A), 1951(c)(2)(C), title XXI, §§2122(b)(4), 2124(a)(3)(D), Oct. 4, 1976, 90 Stat. 1527, 1529, 1530, 1793, 1799, 1800, 1834, 1840, 1915, 1918; Pub. L. 95-600, title IV, §§404(c)(7), 405(c)(4), title VII, §701(f)(3)(C), (E), Nov. 6, 1978, 92 Stat. 2870, 2871, 2901; Pub. L. 96-222, title I, §107(a)(1)(D), Apr. 1, 1980, 94 Stat. 222; Pub. L. 96-223, title II, §251(a)(2)(D), Apr. 2, 1980, 94 Stat. 287; Pub. L. 97-34, title II, §204(e), 212(d)(2)(F), Aug. 13, 1981, 95 Stat. 223, 239; Pub. L. 97-448, title I, §102(a)(7), Jan. 12, 1983, 96 Stat. 2368; Pub. L. 98-369, div. A, title VII, §712(a)(1)(B), July 18, 1984, 98 Stat. 946; Pub. L. 99-514, title II, §242(b)(2), Oct. 22, 1986, 100 Stat. 2181; Pub. L. 100-647, title I, §1002(a)(1), Nov. 10, 1988, 102 Stat. 3352; Pub. L. 101-239, title VII, §7831(b), Dec. 19, 1989, 103 Stat. 2426; Pub. L.

101-508, title XI, §§11801(c)(6)(F), (8)(I), (15), 11812(b)(11), (12), Nov. 5, 1990, 104 Stat. 1388-524, 1388-527, 1388-536; Pub. L. 104-7, §2(b), Apr. 11, 1995, 109 Stat. 93; Pub. L. 104-188, title I, §1702(h)(18), Aug. 20, 1996, 110 Stat. 1874; Pub. L. 105-34, title III, §312(d)(10), Aug. 5, 1997, 111 Stat. 840; Pub. L. 105-206, title VI, §6023(12), July 22, 1998, 112 Stat. 825; Pub. L. 109-58, title XIII, §1331(b)(3), Aug. 8, 2005, 119 Stat. 1024; Pub. L. 109-135, title IV, §402(a)(7), (h), Dec. 21, 2005, 119 Stat. 2610, 2611.)

REFERENCES IN TEXT

Sections 221 and 236 of the National Housing Act, referred to in subsec. (a)(1)(B)(i), (2)(B)(ii), are classified to sections 1715f and 1715z-1, respectively, of Title 12, Banks and Banking.

The date of the enactment of the Revenue Reconciliation Act of 1990, referred to in subsecs. (a)(1)(B)(i), (2)(B)(ii), (4) and (b)(4), is the date of enactment of Pub. L. 101-508, which was approved Nov. 5, 1990.

Section 8 of the United States Housing Act of 1937, referred to in subsec. (a)(1)(B)(ii), is classified to section 1437f of Title 42, The Public Health and Welfare.

The Housing Act of 1949, referred to in subsec. (a)(1)(B)(iv), is act July 15, 1949, ch. 338, 63 Stat. 413, as amended. Title V of the Housing Act of 1949 is classified generally to subchapter III (§1471 et seq.) of chapter 8A of Title 42. For complete classification of this Act to the Code, see Short Title note set out under section 1441 of Title 42 and Tables.

The Tax Reform Act of 1976, referred to in subsec. (b)(3), is Pub. L. 94-455, Oct. 4, 1976, 90 Stat. 1520, as amended. Section 1951(a)(4)(A) of the Act repealed section 168 of this title. For complete classification of this Act to the Code, see Tables.

The Tax Reform Act of 1986, referred to in subsec. (b)(3), is Pub. L. 99-514, Oct. 22, 1986, 100 Stat. 2085. Section 242(a) of the Act repealed section 185 of this title. For complete classification of this Act to the Code, see Tables.

The Revenue Reconciliation Act of 1990, referred to in subsec. (b)(3), is title XI of Pub. L. 101-508, Nov. 5, 1990, 104 Stat. 1388-400. Section 11801(a)(13) of the Act repealed section 188 of this title. For complete classification of this Act to the Code, see Short Title note set out under section 1 of this title and Tables.

The Economic Recovery Tax Act of 1981, referred to in subsec. (b)(4), is Pub. L. 97-34, Aug. 13, 1981, 95 Stat. 172, as amended. Section 191 of this title was repealed by section 212(d)(1) of Pub. L. 97-34. For complete classification of this Act to the Code, see Tables.

AMENDMENTS

2005—Subsec. (b)(3). Pub. L. 109-135, §402(h), struck out “or by section 179D” after “190, or 193”.

Pub. L. 109-58, §1331(b)(3), inserted “or by section 179D” after “190, or 193”.

Subsec. (d)(5) to (8). Pub. L. 109-135, §402(a)(7)(A), redesignated pars. (6) to (8) as (5) to (7), respectively, and struck out heading and text of former par. (5). Text read as follows: “Under regulations prescribed by the Secretary, rules consistent with paragraphs (3) and (4) of this subsection and with subsections (e) and (f) shall apply in the case of transactions described in section 1081 (relating to exchanges in obedience to SEC orders).”

Subsec. (e)(2). Pub. L. 109-135, §402(a)(7)(B), substituted “or (3)” for “(3), or (5)”.

1998—Subsec. (d)(4)(D). Pub. L. 105-206 substituted “section 1033(b)(2)” for “the last sentence of section 1033(b)” in introductory provisions.

1997—Subsec. (d)(7) to (10). Pub. L. 105-34, §312(d)(10)(A), redesignated pars. (9) and (10) as (7) and (8), respectively, and struck out heading and text of former par. (7). Text read as follows: “Subsection (a) shall not apply to a disposition of—

“(A) property to the extent used by the taxpayer as his principal residence (within the meaning of section

1034, relating to rollover of gain on sale of principal residence), and

“(B) property in respect of which the taxpayer meets the age and ownership requirements of section 121 (relating to one-time exclusion of gain from sale of principal residence by individual who has attained age 55) but only to the extent that he meets the use requirements of such section in respect of such property.”

Subsec. (e)(3). Pub. L. 105-34, §312(d)(10)(B), struck out heading and text of par. (3). Text read as follows: “If the basis of property acquired in a transaction described in paragraph (7) of subsection (d) is determined by reference to the basis in the hands of the taxpayer of other property, then the holding period of the property acquired shall include the holding period of such other property.”

1996—Subsec. (e)(4). Pub. L. 104-188 struck out par. (4) which read as follows:

“(4) QUALIFIED LOW-INCOME HOUSING.—The holding period of any section 1250 property acquired which is described in subsection (d)(8)(E)(i) shall include the holding period of the corresponding element of section 1250 property disposed of.”

1995—Subsec. (d)(5). Pub. L. 104-7 struck out “1071 and” before “1081 transactions” in heading and “section 1071 (relating to gain from sale or exchange to effectuate policies of FCC) or” before “section 1081” in text.

1990—Subsec. (a)(1)(B)(i), (2)(B)(ii). Pub. L. 101-508, §11801(c)(15)(A), which directed the insertion of “(as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990)” after “section 1039(b)(1)(B)” in pars. (1)(A)(i) and (2)(B)(ii) of subsec. (a), was executed to pars. (1)(B)(i) and (2)(B)(ii) to reflect the probable intent of Congress.

Subsec. (a)(4), (5). Pub. L. 101-508, §11812(b)(11), added par. (4) and redesignated former par. (4) as (5).

Subsec. (b)(3). Pub. L. 101-508, §11801(c)(6)(F), substituted “188 (as in effect before its repeal by the Revenue Reconciliation Act of 1990),” for “188.”

Subsec. (b)(4). Pub. L. 101-508, §11812(b)(12), substituted “section 167(k) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990)” for “section 167(k)” in two places.

Subsec. (d)(3). Pub. L. 101-508, §11801(c)(8)(I), struck out “371(a), 374(a),” after “332, 351, 361.”

Subsec. (d)(8). Pub. L. 101-508, §11801(c)(15)(B), struck out par. (8) which related to the treatment of gain from the disposition of qualified low-income housing.

Subsecs. (g) to (i). Pub. L. 101-508, §11801(c)(15)(C), redesignated subsecs. (h) and (i) as (g) and (h), respectively, and struck out former subsec. (g) which provided special rules for qualified low-income housing.

1989—Subsec. (b)(5)(A). Pub. L. 101-239, §7831(b)(1), substituted “of property to which section 168 applies” for “of recovery property”.

Subsec. (b)(5)(B). Pub. L. 101-239, §7831(b)(2), substituted “to which section 168 does not apply” for “which is not recovery property”.

1988—Subsec. (d)(11). Pub. L. 100-647 struck out par. (11) which related to section 1245 recovery property.

1986—Subsec. (b)(3). Pub. L. 99-514 inserted “(as in effect before its repeal by the Tax Reform Act of 1986)” after “185”.

1984—Subsec. (a)(4). Pub. L. 98-369 added par. (4).

1983—Subsec. (b)(1). Pub. L. 97-448, §102(a)(7)(B), struck out last sentence providing that, for purposes of defining “additional depreciation”, if a useful life (or salvage value) was used in determining the amount allowed as a deduction for any taxable year, such life (or value) was to be used in determining the depreciation adjustments which would have resulted for such year under the straight line method.

Subsec. (b)(5). Pub. L. 97-448, §102(a)(7)(A), added par. (5).

1981—Subsec. (b)(4). Pub. L. 97-34, §212(d)(2)(F), inserted “(as in effect before its repeal by the Economic Recovery Tax Act of 1981)” after “section 167(k) or 191” in two places.

Subsec. (d)(11). Pub. L. 97-34, §204(e), added par. (11). 1980—Subsec. (a)(1)(B). Pub. L. 96-222 inserted “which was allowed under section 167(k)” at end of last sentence.

Subsec. (b)(3). Pub. L. 96-223 inserted reference to section 193.

1978—Subsec. (b)(3). Pub. L. 95-600, §701(f)(3)(C), struck out reference to section 191.

Subsec. (b)(4). Pub. L. 95-600, §701(f)(3)(E), inserted reference to amortization deduction, amortization adjustments, and to section 191 in two places.

Subsec. (d)(7)(A). Pub. L. 95-600, §405(c)(4), substituted “relating to rollover of gain on sale of principal residence” for “relating to sale or exchange of residence”.

Subsec. (d)(7)(B). Pub. L. 95-600, §404(c)(7), inserted provisions relating to a one-time exclusion and principal residence and substituted “55” for “65”.

1976—Subsec. (a). Pub. L. 94-455, §202(a), in revising text generally, made the following changes:

(1) Added par. (1).

(2) Redesignated as pars. (2) and (3) existing pars. (1) and (2).

(3) Made the following changes in par. (2): inserted in heading “, and before January 1, 1976”; designated introductory text as subpar. “(A) In general”; inserted therein “and the amount determined under paragraph (1)(A)(ii) exceeds the amount determined under paragraph (1)(A)(i), then”; redesignated as cl. (i) existing subpar. (A); substituted therein “attributable to periods after December 31, 1969, and before January 1, 1976” for “(as defined in subsection (b)(1) or (4) attributable to periods after December 31, 1969”; substituted cl. (ii) and concluding text for subpar. (B) and concluding text which read:

“(B) the excess of—

“(i) the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of such property (in the case of any other disposition), over

“(ii) the adjusted basis of such property,

shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any other provision of this subtitle.”; redesignated as subpar. (B) existing subpar. (C); substituted therein introductory “subparagraph (A)” for “paragraph (1)”; and deleted from cl. (ii) “constructed, reconstructed, or acquired by the taxpayer before January 1, 1976,” after “section 1250 property” and “is” before “financed”, and substituted “1” for “one”.

(4) Made the following changes in par. (3): substituted in subpar. (A) “determined under paragraph (1)(A)(ii) exceeds the sum of the amounts determined under paragraphs (1)(A)(i) and (2)(A)(i)” for “determined under paragraph (1)(B) exceeds the amount determined under paragraph (1)(A)”; and substituted subpar. (A)(ii) and concluding text for par. (2)(A)(ii), and concluding text which read:

“(ii) the excess of the amount determined under paragraph (1)(B) over the amount determined under paragraph (1)(A).

shall also be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Such gain shall be recognized notwithstanding any other provisions of this subtitle.”

Subsec. (b)(3). Pub. L. 94-455, §§1951(c)(2)(C), 2122(b)(4), 2124(a)(3)(D), inserted “(as in effect before its repeal by the Tax Reform Act of 1976)” after “section 168” and reference to sections 190 and 191.

Subsec. (d)(4)(B). Pub. L. 94-455, §1901(b)(31)(A), substituted reference to section “1033(a)(2)(A)” for “1033(a)(3)(A)”.

Subsec. (d)(4)(C). Pub. L. 94-455, §1901(b)(31)(B), substituted reference to section “1033(a)(2)” for “1033(a)(3)”.

Subsec. (d)(4)(D). Pub. L. 94-455, §1901(b)(31)(B), (E), substituted reference to sections “1033(a)(2)” and “1033(b)” for “1033(a)(3)” and “1033(c)” §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

Subsec. (d)(5), (8)(F)(ii). Pub. L. 94-455, §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

Subsec. (d)(10). Pub. L. 94-455, §202(b), added par. (10).

Subsec. (f)(1). Pub. L. 94-455, §1901(b)(3)(K), substituted “ordinary income” for “gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231”.

Subsec. (f)(2). Pub. L. 94-455, §202(c)(1), substituted introductory text “the sum of a series of amounts determined for the periods set forth in subsection (a), with the amount for any such period being determined by multiplying” for “the sum of—(A) the amount (if any) determined by multiplying”; substituted subpar. (A) as combined text for prior subpars. (A)(i) and (B)(i) reading “(i) the amount which bears the same ratio to the lower of the amounts specified in subparagraph (A) or (B) of subsection (a)(1) for the section 1250 property as the additional depreciation for such element attributable to periods after December 31, 1969, bears to the sum of the additional depreciation for all elements attributable to periods after December 31, 1969, by” and “(i) the amount which bears the same ratio to the lower of the amounts specified in subsection (a)(2)(A)(i) or (ii) for the section 1250 property as the additional depreciation for such element attributable to periods before January 1, 1970, bears to the sum of the additional depreciation for all elements attributable to periods before January 1, 1970, by”; and substituted subpar. (B) as combined text for prior subpars. (A)(ii) and (B)(ii), inserting therein “for such period” after “for such element”.

Subsec. (g)(1). Pub. L. 94-455, §1901(b)(3)(K), substituted “ordinary income” for “gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231”.

Subsec. (g)(2). Pub. L. 94-455, §202(c)(2), substituted “shall be determined in a manner similar to that provided by subsection (f)(2).” for “shall be the amount determined by multiplying—

“(A) the amount which bears the same ratio to the lower of the additional depreciation or the gain recognized for the section 1250 property disposed of as the additional depreciation for such element bears to the sum of the additional depreciation for all elements disposed of, by

“(B) the applicable percentage for such element.

For purposes of this paragraph, determinations with respect to any element shall be made as if it were a separate property.”

Subsec. (h). Pub. L. 94-455, §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

1975—Subsec. (a)(1)(C)(ii). Pub. L. 93-625 substituted “January 1, 1976” for “January 1, 1975”.

Subsec. (d)(3), (9). Pub. L. 94-81, §2(b), inserted reference to par. (9) in par. (3), and added par. (9).

1971—Subsec. (b)(3). Pub. L. 92-178 inserted reference to section 188.

1969—Subsec. (a). Pub. L. 91-172, §521(b), modified the recapture rules pertaining to residential housing by allowing a 1 percent per month reduction in the amount to be recaptured as ordinary income after the property has been held for 100 full months, with other real property remaining subject to full recapture, applied the existing recapture rules where the sale of property was subject to a binding contract in existence prior to July 25, 1969, provided that changes in the recapture rules are not to apply in federally assisted projects (such as programs under section 221(d)(3) or 236 of the National Housing Act) or to other publicly assisted housing programs under which the return to the investor is limited on a comparable basis, thereby rendering these projects subject to a recapture of the depreciation in full if the sale occurs in the first 12 months and for a phaseout of the recapture of the excess of accelerated over straight-line depreciation after 20 months, the recapture being reduced at the rate of 1 percent per month until 120 months after which no recapture applies, with such recapture rules to continue to apply only with respect to such property constructed, reconstructed, or acquired before Jan. 1, 1975, and applied new recapture rules to depreciation attributable to periods after Dec. 31, 1969.

Subsec. (b)(4). Pub. L. 91-172, §512(c), added par. (4).
 Subsec. (b)(3). Pub. L. 91-172, §704(b)(5), inserted reference to sections 169 and 185.

Subsec. (d). Pub. L. 91-172, §§521(e)(1), 910(b)(1), substituted “subsection (a)” for “subsection (a)(1)” wherever it appears and added par. (8).

Subsec. (e)(4). Pub. L. 91-172, §910(b)(2), added par. (4).
 Subsec. (f)(1). Pub. L. 91-172, §521(e)(2)(A), substituted “subsection (a)” for “subsection (a)(1)”.

Subsec. (f)(2). Pub. L. 91-172, §521(e)(2)(B), redesignated subpars. (A) and (B) as cls. (i) and (ii), respectively, of subpar. (A) and, in cls. (i) and (ii) as so redesignated, inserted reference to depreciation attributable to periods after Dec. 31, 1969, and added subpar. (B).

Subsecs. (g) to (i). Pub. L. 91-172, §910(b)(3), added subsec. (g) and redesignated former subsecs. (g) and (h) as (h) and (i), respectively.

EFFECTIVE DATE OF 2005 AMENDMENT

Amendments by Pub. L. 109-135 effective as if included in the provisions of the Energy Policy Act of 2005, Pub. L. 109-58, to which they relate, but amendment by section 402(a)(7) of Pub. L. 109-135 not applicable with respect to any transaction ordered in compliance with the Public Utility Holding Company Act of 1935 (15 U.S.C. 79 et seq.) before its repeal, see section 402(m) of Pub. L. 109-135, set out as an Effective and Termination Dates of 2005 Amendments note under section 23 of this title.

Amendment by Pub. L. 109-58 applicable to property placed in service after Dec. 31, 2005, see section 1331(d) of Pub. L. 109-58, set out as an Effective Date note under section 179D of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 applicable to sales and exchanges after May 6, 1997, with certain exceptions, see section 312(d) of Pub. L. 105-34, set out as a note under section 121 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 effective, except as otherwise expressly provided, as if included in the provision of the Revenue Reconciliation Act of 1990, Pub. L. 101-508, title XI, to which such amendment relates, see section 1702(i) of Pub. L. 104-188, set out as a note under section 38 of this title.

EFFECTIVE DATE OF 1995 AMENDMENT

Amendment by Pub. L. 104-7 applicable to sales and exchanges on or after January 17, 1995, and to sales and exchanges before such date if FCC tax certificate with respect to such sale or exchange was issued on or after such date, but not applicable with respect to certain binding contracts, see section 2(d) of Pub. L. 104-7, set out as an Effective Date of Repeal note under section 1071 of this title.

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by section 11812(b)(11), (12) of Pub. L. 101-508 applicable to property placed in service after Nov. 5, 1990, but not applicable to any property to which section 168 of this title does not apply by reason of subsec. (f)(5) of section 168, and not applicable to rehabilitation expenditures described in section 252(f)(5) of Pub. L. 99-514, see section 11812(c) of Pub. L. 101-508, set out as a note under section 42 of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101-239 effective as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 7831(g) of Pub. L. 101-239, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of

the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 applicable to that portion of the basis of any property which is attributable to expenditures paid or incurred after Dec. 31, 1986, except as otherwise provided, see section 242(c) of Pub. L. 99-514, set out as an Effective Date of Repeal note under former section 185 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 effective as if included in the provision of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, to which such amendment relates, see section 715 of Pub. L. 98-369, set out as a note under section 31 of this title.

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by Pub. L. 97-448 effective, except as otherwise provided, as if it had been included in the provision of the Economic Recovery Tax Act of 1981, Pub. L. 97-34, to which such amendment relates, see section 109 of Pub. L. 97-448, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1981 AMENDMENT

Amendment by section 204(e) of Pub. L. 97-34 applicable to property placed in service after Dec. 31, 1980, in taxable years ending after that date, see section 209(a) of Pub. L. 97-34, set out as an Effective Date note under section 168 of this title.

Amendment by section 212(d)(2)(F) of Pub. L. 97-34 applicable to expenditures incurred after Dec. 31, 1981, in taxable years ending after such date, see section 212(e) of Pub. L. 97-34, set out as a note under section 46 of this title.

EFFECTIVE DATE OF 1980 AMENDMENTS

Amendment by Pub. L. 96-223 applicable to taxable years beginning after Dec. 31, 1979, see section 251(b) of Pub. L. 96-223, set out as an Effective Date note under section 193 of this title.

Amendment by Pub. L. 96-222 effective, except as otherwise provided, as if it had been included in the provisions of the Revenue Act of 1978, Pub. L. 95-600, to which such amendment relates, see section 201 of Pub. L. 96-222, set out as a note under section 32 of this title.

EFFECTIVE DATE OF 1978 AMENDMENT

Amendment by section 404(c)(7) of Pub. L. 95-600 applicable to sales or exchanges after July 26, 1978, in taxable years ending after such date, see section 404(d)(1) of Pub. L. 95-600, set out as a note under section 121 of this title.

Amendment by section 405(c)(4) of Pub. L. 95-600 applicable to sales and exchanges of residences after July 26, 1978, in taxable years ending after such date, see section 405(d) of Pub. L. 95-600, set out as a note under section 1038 of this title.

Amendment by section 701(f)(3)(C), (E) of Pub. L. 95-600 effective as if included within the amendment of subsec. (b)(3) and (4) by section 2124 of Pub. L. 94-455, see section 701(f)(8) of Pub. L. 95-600, set out as an Effective and Termination Dates of 1978 Amendments note under section 167 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Section 202(d) of Pub. L. 94-455, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that: “The amendments made by this section (other than subsection (b)) [amending this section and section 167 of this title] shall apply for taxable years ending after December 31, 1975. The amendment made by subsection (b) [amending this section] shall apply with respect to proceedings (and to operations of law) referred to in section 1250(d)(10) of the Internal Revenue Code of 1986

[formerly I.R.C. 1954] which begin after December 31, 1975.”

Amendment by section 1901(b)(3)(K), (31)(A), (B), (E) of Pub. L. 94-455 effective for taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

Amendment by section 1951(c)(2)(C) of Pub. L. 94-455 applicable to taxable years beginning after Dec. 31, 1976, see section 1951(d) of Pub. L. 94-455, set out as a note under section 72 of this title.

Amendment by section 2122(b)(4) of Pub. L. 94-455 applicable to taxable years beginning after Dec. 31, 1976, and before Jan. 1, 1983, see section 2122(c) of Pub. L. 94-455, as amended by Pub. L. 96-167, 9(c), Dec. 29, 1979, 93 Stat. 1278, set out as a note under section 190 of this title.

Amendment by section 2124(a)(3)(D) of Pub. L. 94-455 applicable with respect to additions to capital accounts made after June 14, 1976 and before June 15, 1981, see section 2124(a)(4) of Pub. L. 94-455, set out as an Effective Date note under section 642 of this title.

EFFECTIVE DATE OF 1975 AMENDMENTS

Section 2(c) of Pub. L. 94-81 provided that:

“(1) IN GENERAL.—Except as provided in paragraph (2) the amendments made by this section [amending this section and section 1245 of this title] shall apply to dispositions after December 31, 1969, in taxable years ending after such date.

“(2) ELECTION FOR PAST TRANSACTIONS.—In the case of any disposition occurring before the date of the enactment of this Act [Aug. 9, 1975], the amendments made by this section shall apply only if the organization acquiring the property elects (in the manner provided by regulations prescribed by the Secretary of the Treasury or his delegate) within 1 year after the date of the enactment of this Act to have such amendments apply with respect to such property.”

Amendment by Pub. L. 93-625 applicable with respect to property placed in service after Dec. 31, 1973, see section 5(d) of Pub. L. 93-625, set out as a note under section 167 of this title.

EFFECTIVE DATE OF 1971 AMENDMENT

Amendment by Pub. L. 92-178 applicable to taxable years ending after Dec. 31, 1971, see section 303(d) of Pub. L. 92-178, set out as a note under section 642 of this title.

EFFECTIVE DATE OF 1969 AMENDMENT

Amendment by section 521(b), (c), (e) of Pub. L. 91-172 applicable with respect to taxable years ending after July 24, 1969, see section 521(g) of Pub. L. 91-172, set out as a note under section 167 of this title.

Amendment by section 704(b)(5) of Pub. L. 91-172 applicable to taxable years ending after Dec. 31, 1968, see section 704(c) of Pub. L. 91-172, set out as an Effective Date note under section 169 of this title.

Section 910(d) of Pub. L. 91-172, as amended by Pub. L. 99-514, § 2, Oct. 22, 1986, 100 Stat. 2095, provided that: “The amendments made by this section [enacting section 1039 of this title and amending this section] shall apply to approved dispositions of qualified housing projects (within the meaning of section 1039 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] as added by subsection (a)) after October 9, 1969.”

EFFECTIVE DATE

Section 231(c) of Pub. L. 88-272 provided that: “The amendments made by this section [enacting this section and amending sections 170, 301, 312, 341, 453, 751, and the analysis preceding section 1231 of this title] shall apply to dispositions after December 31, 1963, in taxable years ending after such date.”

SAVINGS PROVISION

For provisions that nothing in amendment by Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of

income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

[§ 1251. Repealed. Pub. L. 98-369, div. A, title IV, § 492(a), July 18, 1984, 98 Stat. 853]

Section, added Pub. L. 91-172, title II, § 211(a), Dec. 30, 1969, 83 Stat. 566; amended Pub. L. 92-178, title III, § 305(a), Dec. 10, 1971, 85 Stat. 524; Pub. L. 94-455, title II, § 206(a), (b)(1), (2), title XIV, § 1402(b)(1)(Z), (2), title XIX, §§ 1901(b)(3)(K), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1535, 1732, 1793, 1834; Pub. L. 97-354, § 5(a)(36), Oct. 19, 1982, 96 Stat. 1695; Pub. L. 98-369, div. A, title X, § 1001(b)(23), (e), July 18, 1984, 98 Stat. 1012, related to gain from disposition of property used in farming where farm losses offset nonfarm income.

EFFECTIVE DATE OF REPEAL

Repeal applicable to taxable years beginning after Dec. 31, 1983, see section 492(d) of Pub. L. 98-369, set out as an Effective Date of 1984 Amendment note under section 170 of this title.

§ 1252. Gain from disposition of farm land

(a) General rule

(1) Ordinary income

Except as otherwise provided in this section, if farm land which the taxpayer has held for less than 10 years is disposed of during a taxable year beginning after December 31, 1969, the lower of—

(A) the applicable percentage of the aggregate of the deductions allowed under sections 175 (relating to soil and water conservation expenditures) and 182 (relating to expenditures by farmers for clearing land) for expenditures made by the taxpayer after December 31, 1969, with respect to the farm land or

(B) the excess of—

- (i) the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of the farm land (in the case of any other disposition), over
- (ii) the adjusted basis of such land,

shall be treated as ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(2) Farm land

For purposes of this section, the term “farm land” means any land with respect to which deductions have been allowed under sections 175 (relating to soil and water conservation expenditures) or 182 (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986).

(3) Applicable percentage

For purposes of this section—

If the farm land is disposed of—	The applicable percentage is—
Within 5 years after the date it was acquired	100 percent.
Within the sixth year after it was acquired	80 percent.
Within the seventh year after it was acquired	60 percent.
Within the eighth year after it was acquired	40 percent.

If the farm land is disposed of—	The applicable percentage is—
Within the ninth year after it was acquired	20 percent.
10 years or more years after it was acquired	0 percent.

(b) Special rules

Under regulations prescribed by the Secretary, rules similar to the rules of section 1245 shall be applied for purposes of this section.

(Added Pub. L. 91-172, title II, §214(a), Dec. 30, 1969, 83 Stat. 572; amended Pub. L. 94-455, title XIX, §§1901(b)(3)(K), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1793, 1834; Pub. L. 98-369, div. A, title IV, §492(b)(5), July 18, 1984, 98 Stat. 854; Pub. L. 99-514, title IV, §402(b)(2), Oct. 22, 1986, 100 Stat. 2221.)

REFERENCES IN TEXT

The date of the enactment of the Tax Reform Act of 1986, referred to in subsec. (a)(1)(A), is the date of enactment of Pub. L. 99-514, which was approved Oct. 22, 1986. Section 402(a) of the Tax Reform Act of 1986 repealed section 182 of this title.

AMENDMENTS

1986—Subsec. (a)(1)(A). Pub. L. 99-514 substituted “(as in effect on the day before the date of the enactment of the Tax Reform Act of 1986)” for “(relating to expenditures by farmers for clearing land)”.

1984—Subsec. (a)(1). Pub. L. 98-369 struck out “, except that this section shall not apply to the extent section 1251 applies to such gain” after “of this subtitle” in last sentence.

1976—Subsec. (a)(1). Pub. L. 94-455, §1901(b)(3)(K), substituted “ordinary income” for “gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231”.

Subsec. (b). Pub. L. 94-455, §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 applicable to amounts paid or incurred after Dec. 31, 1985, in taxable years ending after such date, see section 402(c) of Pub. L. 99-514, set out as an Effective Date of Repeal note under former section 182 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 applicable to taxable years beginning after Dec. 31, 1983, see section 492(d) of Pub. L. 98-369, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by section 1901(b)(3)(K) of Pub. L. 94-455 effective for taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

EFFECTIVE DATE

Section 214(c) of Pub. L. 91-172 provided that: “The amendments made by this section [enacting this section] shall apply to taxable years beginning after December 31, 1969.”

§ 1253. Transfers of franchises, trademarks, and trade names**(a) General rule**

A transfer of a franchise, trademark, or trade name shall not be treated as a sale or exchange of a capital asset if the transferor retains any significant power, right, or continuing interest with respect to the subject matter of the franchise, trademark, or trade name.

(b) Definitions

For purposes of this section—

(1) Franchise

The term “franchise” includes an agreement which gives one of the parties to the agreement the right to distribute, sell, or provide goods, services, or facilities, within a specified area.

(2) Significant power, right, or continuing interest

The term “significant power, right, or continuing interest” includes, but is not limited to, the following rights with respect to the interest transferred:

(A) A right to disapprove any assignment of such interest, or any part thereof.

(B) A right to terminate at will.

(C) A right to prescribe the standards of quality of products used or sold, or of services furnished, and of the equipment and facilities used to promote such products or services.

(D) A right to require that the transferee sell or advertise only products or services of the transferor.

(E) A right to require that the transferee purchase substantially all of his supplies and equipment from the transferor.

(F) A right to payments contingent on the productivity, use, or disposition of the subject matter of the interest transferred, if such payments constitute a substantial element under the transfer agreement.

(3) Transfer

The term “transfer” includes the renewal of a franchise, trademark, or trade name.

(c) Treatment of contingent payments by transferor

Amounts received or accrued on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name which are contingent on the productivity, use, or disposition of the franchise, trademark, or trade name transferred shall be treated as amounts received or accrued from the sale or other disposition of property which is not a capital asset.

(d) Treatment of payments by transferee**(1) Contingent serial payments****(A) In general**

Any amount described in subparagraph (B) which is paid or incurred during the taxable year on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name shall be allowed as a deduction under section 162(a) (relating to trade or business expenses).

(B) Amounts to which paragraph applies

An amount is described in this subparagraph if it—

(i) is contingent on the productivity, use, or disposition of the franchise, trademark, or trade name, and

(ii) is paid as part of a series of payments—

(I) which are payable not less frequently than annually throughout the

entire term of the transfer agreement, and

(II) which are substantially equal in amount (or payable under a fixed formula).

(2) Other payments

Any amount paid or incurred on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name to which paragraph (1) does not apply shall be treated as an amount chargeable to capital account.

(3) Renewals, etc.

For purposes of determining the term of a transfer agreement under this section, there shall be taken into account all renewal options (and any other period for which the parties reasonably expect the agreement to be renewed).

(Added Pub. L. 91-172, title V, §516(c)(1), Dec. 30, 1969, 83 Stat. 647; amended Pub. L. 94-455, title XIX, §1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Pub. L. 101-239, title VII, §7622(a)-(c), Dec. 19, 1989, 103 Stat. 2377; Pub. L. 101-508, title XI, §11701(i), Nov. 5, 1990, 104 Stat. 1388-508; Pub. L. 103-66, title XIII, §13261(c), Aug. 10, 1993, 107 Stat. 539; Pub. L. 104-188, title I, §1704(t)(47), Aug. 20, 1996, 110 Stat. 1889; Pub. L. 108-357, title VIII, §886(b)(3), Oct. 22, 2004, 118 Stat. 1641.)

AMENDMENTS

2004—Subsec. (e). Pub. L. 108-357 struck out heading and text of subsec. (e). Text read as follows: “This section shall not apply to the transfer of a franchise to engage in professional football, basketball, baseball, or other professional sport.”

1996—Subsec. (d)(4). Pub. L. 104-188 provided that section 11701(i) of Pub. L. 101-508 shall be applied as if “subsection” appeared instead of “section” in the material proposed to be stricken. See 1990 Amendment note below.

1993—Subsec. (d)(2) to (5). Pub. L. 103-66 added pars. (2) and (3) and struck out former pars. (2) relating to deduction of certain payments for transfer of a franchise, trademark, or trade name not treated as sale or exchange of capital asset, (3) relating to treatment of amounts paid or incurred on account of transfer, sale, or other disposition of a franchise, trademark, or trade name to which pars. (1) and (2) did not apply, (4) relating to renewals for purposes of determining term of transfer agreement under this section or period of amortization under this subtitle, and (5) relating to rules applicable to this subsection.

1990—Subsec. (d)(4). Pub. L. 101-508, §11701(i), which directed the substitution of “under this section or any period of amortization under this subtitle for any payment described in this section” for “or any period of amortization under this section”, was executed by making the substitution for “or any period of amortization under this subsection”. See 1996 Amendment note above.

1989—Subsec. (d)(1). Pub. L. 101-239, §7622(a), substituted “serial payments” for “payments” in heading and amended text generally. Prior to amendment, text read as follows: “Amounts paid or incurred during the taxable year on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name which are contingent on the productivity, use, or disposition of the franchise, trademark, or trade name transferred shall be allowed as a deduction under section 162(a) (relating to trade or business expenses).”

Subsec. (d)(2). Pub. L. 101-239, §7622(b), designated existing provisions as subpar. (A), inserted subpar. heading, redesignated former subpars. (A) to (C) as cls. (i) to (iii), respectively, and former cls. (i) and (ii) of former

subpar. (B) as subcls. (I) and (II), respectively, of cl. (ii), and added subpar. (B).

Subsec. (d)(3) to (5). Pub. L. 101-239, §7622(c), added pars. (3) to (5).

1976—Subsec. (d)(2)(C). Pub. L. 94-455 struck out “or his delegate” after “Secretary”.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to property acquired after Oct. 22, 2004, see section 886(c)(1) of Pub. L. 108-357, set out as a note under section 197 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103-66 applicable, except as otherwise provided, with respect to property acquired after Aug. 10, 1993, see section 13261(g) of Pub. L. 103-66, set out as an Effective Date note under section 197 of this title.

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by Pub. L. 101-508 effective, except as otherwise provided, as if included in the provision of the Revenue Reconciliation Act of 1989, Pub. L. 101-239, title VII, to which such amendment relates, see section 11701(n) of Pub. L. 101-508, set out as a note under section 42 of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101-239 applicable to transfers after Oct. 2, 1989, but not applicable to any transfer pursuant to a written binding contract in effect on Oct. 2, 1989, and at all times thereafter before the transfer, see section 7622(c)[(e)] of Pub. L. 101-239, set out as a note under section 167 of this title.

EFFECTIVE DATE

Section applicable to transfers after Dec. 31, 1969, except that subsec. (d)(1) shall, at the election of the taxpayer (made at such time and in such manner as the Secretary or his delegate may by regulations prescribe), apply to transfers before Jan. 1, 1970, but only with respect to payments made in taxable years ending after Dec. 31, 1969, and beginning before Jan. 1, 1980, see section 516(d)(3) of Pub. L. 91-172, set out as a note under section 1001 of this title.

§ 1254. Gain from disposition of interest in oil, gas, geothermal, or other mineral properties

(a) General rule

(1) Ordinary income

If any section 1254 property is disposed of, the lesser of—

(A) the aggregate amount of—

(i) expenditures which have been deducted by the taxpayer or any person under section 263, 616, or 617 with respect to such property and which, but for such deduction, would have been included in the adjusted basis of such property, and

(ii) the deductions for depletion under section 611 which reduced the adjusted basis of such property, or

(B) the excess of—

(i) in the case of—

(I) a sale, exchange, or involuntary conversion, the amount realized, or

(II) in the case of any other disposition, the fair market value of such property, over

(ii) the adjusted basis of such property,

shall be treated as gain which is ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(2) Disposition of portion of property

For purposes of paragraph (1)—

(A) In the case of the disposition of a portion of section 1254 property (other than an undivided interest), the entire amount of the aggregate expenditures or deductions described in paragraph (1)(A) with respect to such property shall be treated as allocable to such portion to the extent of the amount of the gain to which paragraph (1) applies.

(B) In the case of the disposition of an undivided interest in a section 1254 property (or a portion thereof), a proportionate part of the expenditures or deductions described in paragraph (1)(A) with respect to such property shall be treated as allocable to such undivided interest to the extent of the amount of the gain to which paragraph (1) applies.

This paragraph shall not apply to any expenditures to the extent the taxpayer establishes to the satisfaction of the Secretary that such expenditures do not relate to the portion (or interest therein) disposed of.

(3) Section 1254 property

The term “section 1254 property” means any property (within the meaning of section 614) if—

(A) any expenditures described in paragraph (1)(A) are properly chargeable to such property, or

(B) the adjusted basis of such property includes adjustments for deductions for depletion under section 611.

(4) Adjustment for amounts included in gross income under section 617(b)(1)(A)

The amount of the expenditures referred to in paragraph (1)(A)(i) shall be properly adjusted for amounts included in gross income under section 617(b)(1)(A).

(b) Special rules under regulations

Under regulations prescribed by the Secretary—

(1) rules similar to the rule of subsection (g) of section 617 and to the rules of subsections (b) and (c) of section 1245 shall be applied for purposes of this section; and

(2) in the case of the sale or exchange of stock in an S corporation, rules similar to the rules of section 751 shall be applied to that portion of the excess of the amount realized over the adjusted basis of the stock which is attributable to expenditures referred to in subsection (a)(1)(A) of this section.

(Added Pub. L. 94-455, title II, §205(a), Oct. 4, 1976, 90 Stat. 1533; amended Pub. L. 95-618, title IV, §402(c)(1)–(3), Nov. 9, 1978, 92 Stat. 3202; Pub. L. 97-354, §5(a)(37), Oct. 19, 1982, 96 Stat. 1696; Pub. L. 99-514, title IV, §413(a), Oct. 22, 1986, 100 Stat. 2227; Pub. L. 100-647, title I, §1004(c), Nov. 10, 1988, 102 Stat. 3387.)

AMENDMENTS

1988—Subsec. (a)(4). Pub. L. 100-647 added par. (4).

1986—Pub. L. 99-514 amended section generally, substituting “geothermal, or other mineral properties” for “or geothermal property” in section catchline, revising and restating subsec. (a), pars. (1) to (4) as pars. (1) to

(3), and reenacting subsec. (b) without change except for substituting “rule of subsection (g)” for “rules of subsection (g)” in par. (1).

1982—Subsec. (b)(2). Pub. L. 97-354 substituted “an S corporation” for “an electing small business corporation (as defined in section 1371(b))”.

1978—Pub. L. 95-618, §402(c)(3), substituted “oil, gas, or geothermal” for “oil or gas” in section catchline.

Subsec. (a)(1), (2). Pub. L. 95-618, §402(c)(1), substituted “oil, gas, or geothermal property” for “oil or gas property” wherever appearing.

Subsec. (a)(3). Pub. L. 95-618, §402(c)(2), substituted “Oil, gas, or geothermal” for “Oil or gas” in heading and in text substituted “The term ‘oil, gas, or geothermal property’ means” for “The term ‘oil or gas property’ means”.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Section 413(c) of Pub. L. 99-514 provided that:

“(1) IN GENERAL.—The amendments made by this section [amending this section and section 617 of this title] shall apply to any disposition of property which is placed in service by the taxpayer after December 31, 1986.

“(2) EXCEPTION FOR BINDING CONTRACTS.—The amendments made by this section shall not apply to any disposition of property placed in service after December 31, 1986, if such property was acquired pursuant to a written contract which was entered into before September 26, 1985, and which was binding at all times thereafter.”

EFFECTIVE DATE OF 1982 AMENDMENT

Amendment by Pub. L. 97-354 applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as an Effective Date note under section 1361 of this title.

EFFECTIVE DATE OF 1978 AMENDMENT

Amendment by Pub. L. 95-618 applicable with respect to wells commenced on or after Oct. 1, 1978, in taxable years ending on or after such date, see section 402(e) of Pub. L. 95-618, set out as a note under section 263 of this title.

EFFECTIVE DATE

Section 205(e) of Pub. L. 94-455 provided that: “The amendments made by this section [enacting this section and amending sections 163, 170, 301, 312, 341, 453, and 751 of this title] shall apply with respect to taxable years ending after December 31, 1975.”

§ 1255. Gain from disposition of section 126 property**(a) General rule****(1) Ordinary income**

Except as otherwise provided in this section, if section 126 property is disposed of, the lower of—

(A) the applicable percentage of the aggregate payments, with respect to such property, excluded from gross income under section 126, or

(B) the excess of—

(i) the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of such section 126 property (in the case of any other disposition), over

(ii) the adjusted basis of such property, shall be treated as ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle, except that this section shall not apply to the extent such gain is recognized as ordinary income under any other provision of this part.

(2) Section 126 property

For purposes of this section, “section 126 property” means any property acquired, improved, or otherwise modified by the application of payments excluded from gross income under section 126.

(3) Applicable percentage

For purposes of this section, if section 126 property is disposed of less than 10 years after the date of receipt of payments excluded from gross income under section 126, the applicable percentage is 100 percent. If section 126 property is disposed of more than 10 years after such date, the applicable percentage is 100 percent reduced (but not below zero) by 10 percent for each year or part thereof in excess of 10 years such property was held after the date of receipt of the payments.

(b) Special rules

Under regulations prescribed by the Secretary—

(1) rules similar to the rules applicable under section 1245 shall be applied for purposes of this section, and

(2) for purposes of sections 170(e),¹ and 751(c), amounts treated as ordinary income under this section shall be treated in the same manner as amounts treated as ordinary income under section 1245.

(Added Pub. L. 95-600, title V, § 543(c)(1), Nov. 6, 1978, 92 Stat. 2890; amended Pub. L. 96-222, title I, § 105(a)(7)(B), (D), Apr. 1, 1980, 94 Stat. 221; Pub. L. 96-471, § 2(b)(6), Oct. 19, 1980, 94 Stat. 2254; Pub. L. 99-514, title V, § 511(d)(2)(A), title VI, § 631(e)(14), Oct. 22, 1986, 100 Stat. 2248, 2275; Pub. L. 100-647, title I, § 1005(c)(10), Nov. 10, 1988, 102 Stat. 3392; Pub. L. 108-27, title III, § 302(e)(4)(B)(ii), May 28, 2003, 117 Stat. 764.)

AMENDMENT OF SECTION

For termination of amendment by section 303 of Pub. L. 108-27, see Effective and Termination Dates of 2003 Amendment note below.

AMENDMENTS

2003—Subsec. (b)(2). Pub. L. 108-27, §§ 302(e)(4)(B)(ii), 303, temporarily struck out “, 341(e)(12),” after “170(e)”. See Effective and Termination Dates of 2003 Amendment note below.

1988—Subsec. (b)(2). Pub. L. 100-647 amended Pub. L. 99-514, § 511(d)(2)(A), see 1986 Amendment note below.

1986—Subsec. (b)(2). Pub. L. 99-514, § 511(d)(2)(A), as amended by Pub. L. 100-647, struck out “163(d),” after “sections”.

Pub. L. 99-514, § 631(e)(14), struck out “453B(d)(2)” after “341(e)(12),”.

1980—Subsec. (a)(1)(B). Pub. L. 96-222, § 105(a)(7)(B), inserted following cl. (ii) provisions requiring that such gain be recognized notwithstanding any other provision of this subtitle, except that this section shall not apply to the extent such gain is recognized as ordinary income under any other provision of this part.

Subsec. (b)(2). Pub. L. 96-471 substituted “453B(d)(2)” for “453(d)(4)(B)”.

Pub. L. 96-222, § 105(a)(7)(D), inserted “for purposes of sections 163(d), 170(e), 341(e)(12), 453(d)(4)(B), and 751(c)” before “amounts treated as”.

EFFECTIVE AND TERMINATION DATES OF 2003 AMENDMENT

Amendment by Pub. L. 108-27 applicable, except as otherwise provided, to taxable years beginning after Dec. 31, 2002, see section 302(f) of Pub. L. 108-27, set out as a note under section 1 of this title.

Amendment by Pub. L. 108-27 inapplicable to taxable years beginning after Dec. 31, 2012, and the Internal Revenue Code of 1986 to be applied and administered to such years as if such amendment had never been enacted, see section 303 of Pub. L. 108-27, as amended, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 511(d)(2)(A) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, see section 511(e) of Pub. L. 99-514, set out as a note under section 163 of this title.

Amendment by section 631(e)(14) of Pub. L. 99-514 applicable to any distribution in complete liquidation, and any sale or exchange, made by a corporation after July 31, 1986, unless such corporation is completely liquidated before Jan. 1, 1987, any transaction described in section 338 of this title for which the acquisition date occurs after Dec. 31, 1986, and any distribution, not in complete liquidation, made after Dec. 31, 1986, with exceptions and special and transitional rules, see section 633 of Pub. L. 99-514, set out as an Effective Date note under section 336 of this title.

EFFECTIVE DATE OF 1980 AMENDMENTS

For effective date of amendment by Pub. L. 96-471, see section 6(a)(1) of Pub. L. 96-471, set out as an Effective Date note under section 453 of this title.

Amendment by Pub. L. 96-222 effective, except as otherwise provided, as if it had been included in the provisions of the Revenue Act of 1978, Pub. L. 95-600, to which such amendment relates, see section 201 of Pub. L. 96-222, set out as a note under section 32 of this title.

EFFECTIVE DATE

Section effective with respect to grants made under the programs after Sept. 30, 1979, see section 543(d) of Pub. L. 95-600, set out as a note under section 126 of this title.

§ 1256. Section 1256 contracts marked to market

(a) General rule

For purposes of this subtitle—

(1) each section 1256 contract held by the taxpayer at the close of the taxable year shall be treated as sold for its fair market value on the last business day of such taxable year (and any gain or loss shall be taken into account for the taxable year),

(2) proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account by reason of paragraph (1),

(3) any gain or loss with respect to a section 1256 contract shall be treated as—

(A) short-term capital gain or loss, to the extent of 40 percent of such gain or loss, and

¹ So in original. The comma probably should not appear.

(B) long-term capital gain or loss, to the extent of 60 percent of such gain or loss, and

(4) if all the offsetting positions making up any straddle consist of section 1256 contracts to which this section applies (and such straddle is not part of a larger straddle), sections 1092 and 263(g) shall not apply with respect to such straddle.

(b) Section 1256 contract defined

(1) In general

For purposes of this section, the term “section 1256 contract” means—

- (A) any regulated futures contract,
- (B) any foreign currency contract,
- (C) any nonequity option,
- (D) any dealer equity option, and
- (E) any dealer securities futures contract.

(2) Exceptions

The term “section 1256 contract” shall not include—

- (A) any securities futures contract or option on such a contract unless such contract or option is a dealer securities futures contract, or
- (B) any interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement.

(c) Terminations, etc.

(1) In general

The rules of paragraphs (1), (2), and (3) of subsection (a) shall also apply to the termination (or transfer) during the taxable year of the taxpayer’s obligation (or rights) with respect to a section 1256 contract by offsetting, by taking or making delivery, by exercise or being exercised, by assignment or being assigned, by lapse, or otherwise.

(2) Special rule where taxpayer takes delivery on or exercises part of straddle

If—

- (A) 2 or more section 1256 contracts are part of a straddle (as defined in section 1092(c)), and
- (B) the taxpayer takes delivery under or exercises any of such contracts,

then, for purposes of this section, each of the other such contracts shall be treated as terminated on the day on which the taxpayer took delivery.

(3) Fair market value taken into account

For purposes of this subsection, fair market value at the time of the termination (or transfer) shall be taken into account.

(d) Elections with respect to mixed straddles

(1) Election

The taxpayer may elect to have this section not to apply to all section 1256 contracts which are part of a mixed straddle.

(2) Time and manner

An election under paragraph (1) shall be made at such time and in such manner as the Secretary may by regulations prescribe.

(3) Election revocable only with consent

An election under paragraph (1) shall apply to the taxpayer’s taxable year for which made and to all subsequent taxable years, unless the Secretary consents to a revocation of such election.

(4) Mixed straddle

For purposes of this subsection, the term “mixed straddle” means any straddle (as defined in section 1092(c))—

(A) at least 1 (but not all) of the positions of which are section 1256 contracts, and

(B) with respect to which each position forming part of such straddle is clearly identified, before the close of the day on which the first section 1256 contract forming part of the straddle is acquired (or such earlier time as the Secretary may prescribe by regulations), as being part of such straddle.

(e) Mark to market not to apply to hedging transactions

(1) Section not to apply

Subsection (a) shall not apply in the case of a hedging transaction.

(2) Definition of hedging transaction

For purposes of this subsection, the term “hedging transaction” means any hedging transaction (as defined in section 1221(b)(2)(A)) if, before the close of the day on which such transaction was entered into (or such earlier time as the Secretary may prescribe by regulations), the taxpayer clearly identifies such transaction as being a hedging transaction.

(3) Special rule for syndicates

(A) In general

Notwithstanding paragraph (2), the term “hedging transaction” shall not include any transaction entered into by or for a syndicate.

(B) Syndicate defined

For purposes of subparagraph (A), the term “syndicate” means any partnership or other entity (other than a corporation which is not an S corporation) if more than 35 percent of the losses of such entity during the taxable year are allocable to limited partners or limited entrepreneurs (within the meaning of section 464(e)(2)).

(C) Holdings attributable to active management

For purposes of subparagraph (B), an interest in an entity shall not be treated as held by a limited partner or a limited entrepreneur (within the meaning of section 464(e)(2))—

(i) for any period if during such period such interest is held by an individual who actively participates at all times during such period in the management of such entity,

(ii) for any period if during such period such interest is held by the spouse, children, grandchildren, and parents of an individual who actively participates at all times during such period in the management of such entity,

(iii) if such interest is held by an individual who actively participated in the management of such entity for a period of not less than 5 years,

(iv) if such interest is held by the estate of an individual who actively participated in the management of such entity or is held by the estate of an individual if with respect to such individual such interest was at any time described in clause (ii), or

(v) if the Secretary determines (by regulations or otherwise) that such interest should be treated as held by an individual who actively participates in the management of such entity, and that such entity and such interest are not used (or to be used) for tax-avoidance purposes.

For purposes of this subparagraph, a legally adopted child of an individual shall be treated as a child of such individual by blood.

(4) Limitation on losses from hedging transactions

(A) In general

(i) Limitation

Any hedging loss for a taxable year which is allocable to any limited partner or limited entrepreneur (within the meaning of paragraph (3)) shall be allowed only to the extent of the taxable income of such limited partner or entrepreneur for such taxable year attributable to the trade or business in which the hedging transactions were entered into. For purposes of the preceding sentence, taxable income shall be determined by not taking into account items attributable to hedging transactions.

(ii) Carryover of disallowed loss

Any hedging loss disallowed under clause (i) shall be treated as a deduction attributable to a hedging transaction allowable in the first succeeding taxable year.

(B) Exception where economic loss

Subparagraph (A)(i) shall not apply to any hedging loss to the extent that such loss exceeds the aggregate unrecognized gains from hedging transactions as of the close of the taxable year attributable to the trade or business in which the hedging transactions were entered into.

(C) Exception for certain hedging transactions

In the case of any hedging transaction relating to property other than stock or securities, this paragraph shall apply only in the case of a taxpayer described in section 465(a)(1).

(D) Hedging loss

The term “hedging loss” means the excess of—

(i) the deductions allowable under this chapter for the taxable year attributable to hedging transactions (determined without regard to subparagraph (A)(i)), over

(ii) income received or accrued by the taxpayer during such taxable year from such transactions.

(E) Unrecognized gain

The term “unrecognized gain” has the meaning given to such term by section 1092(a)(3).

(f) Special rules

(1) Denial of capital gains treatment for property identified as part of a hedging transaction

For purposes of this title, gain from any property shall in no event be considered as gain from the sale or exchange of a capital asset if such property was at any time personal property (as defined in section 1092(d)(1)) identified under subsection (e)(2) by the taxpayer as being part of a hedging transaction.

(2) Subsection (a)(3) not to apply to ordinary income property

Paragraph (3) of subsection (a) shall not apply to any gain or loss which, but for such paragraph, would be ordinary income or loss.

(3) Capital gain treatment for traders in section 1256 contracts

(A) In general

For purposes of this title, gain or loss from trading of section 1256 contracts shall be treated as gain or loss from the sale or exchange of a capital asset.

(B) Exception for certain hedging transactions

Subparagraph (A) shall not apply to any section 1256 contract to the extent such contract is held for purposes of hedging property if any loss with respect to such property in the hands of the taxpayer would be ordinary loss.

(C) Treatment of underlying property

For purposes of determining whether gain or loss with respect to any property is ordinary income or loss, the fact that the taxpayer is actively engaged in dealing in or trading section 1256 contracts related to such property shall not be taken into account.

(4) Special rule for dealer equity options and dealer securities futures contracts of limited partners or limited entrepreneurs

In the case of any gain or loss with respect to dealer equity options, or dealer securities futures contracts, which are allocable to limited partners or limited entrepreneurs (within the meaning of subsection (e)(3))—

(A) paragraph (3) of subsection (a) shall not apply to any such gain or loss, and

(B) all such gains or losses shall be treated as short-term capital gains or losses, as the case may be.

(5) Special rule related to losses

Section 1091 (relating to loss from wash sales of stock or securities) shall not apply to any loss taken into account by reason of paragraph (1) of subsection (a).

(g) Definitions

For purposes of this section—

(1) Regulated futures contracts defined

The term “regulated futures contract” means a contract—

(A) with respect to which the amount required to be deposited and the amount which may be withdrawn depends on a system of marking to market, and

(B) which is traded on or subject to the rules of a qualified board or exchange.

(2) Foreign currency contract defined

(A) Foreign currency contract

The term “foreign currency contract” means a contract—

(i) which requires delivery of, or the settlement of which depends on the value of, a foreign currency which is a currency in which positions are also traded through regulated futures contracts,

(ii) which is traded in the interbank market, and

(iii) which is entered into at arm's length at a price determined by reference to the price in the interbank market.

(B) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of subparagraph (A), including regulations excluding from the application of subparagraph (A) any contract (or type of contract) if its application there-to would be inconsistent with such purposes.

(3) Nonequity option

The term “nonequity option” means any listed option which is not an equity option.

(4) Dealer equity option

The term “dealer equity option” means, with respect to an options dealer, any listed option which—

(A) is an equity option,

(B) is purchased or granted by such options dealer in the normal course of his activity of dealing in options, and

(C) is listed on the qualified board or exchange on which such options dealer is registered.

(5) Listed option

The term “listed option” means any option (other than a right to acquire stock from the issuer) which is traded on (or subject to the rules of) a qualified board or exchange.

(6) Equity option

The term “equity option” means any option—

(A) to buy or sell stock, or

(B) the value of which is determined directly or indirectly by reference to any stock or any narrow-based security index (as defined in section 3(a)(55) of the Securities Exchange Act of 1934, as in effect on the date of the enactment of this paragraph).

The term “equity option” includes such an option on a group of stocks only if such group meets the requirements for a narrow-based security index (as so defined). The Secretary may prescribe regulations regarding the status of options the values of which are determined directly or indirectly by reference to any index which becomes (or ceases to be) a narrow-based security index (as so defined).

(7) Qualified board or exchange

The term “qualified board or exchange” means—

(A) a national securities exchange which is registered with the Securities and Exchange Commission,

(B) a domestic board of trade designated as a contract market by the Commodity Futures Trading Commission, or

(C) any other exchange, board of trade, or other market which the Secretary determines has rules adequate to carry out the purposes of this section.

(8) Options dealer

(A) In general

The term “options dealer” means any person registered with an appropriate national securities exchange as a market maker or specialist in listed options.

(B) Persons trading in other markets

In any case in which the Secretary makes a determination under subparagraph (C) of paragraph (7), the term “options dealer” also includes any person whom the Secretary determines performs functions similar to the persons described in subparagraph (A). Such determinations shall be made to the extent appropriate to carry out the purposes of this section.

(9) Dealer securities futures contract

(A) In general

The term “dealer securities futures contract” means, with respect to any dealer, any securities futures contract, and any option on such a contract, which—

(i) is entered into by such dealer (or, in the case of an option, is purchased or granted by such dealer) in the normal course of his activity of dealing in such contracts or options, as the case may be, and

(ii) is traded on a qualified board or exchange.

(B) Dealer

For purposes of subparagraph (A), a person shall be treated as a dealer in securities futures contracts or options on such contracts if the Secretary determines that such person performs, with respect to such contracts or options, as the case may be, functions similar to the functions performed by persons described in paragraph (8)(A). Such determination shall be made to the extent appropriate to carry out the purposes of this section.

(C) Securities futures contract

The term “securities futures contract” has the meaning given to such term by section 1234B.

(Added Pub. L. 97-34, title V, §503(a), Aug. 13, 1981, 95 Stat. 327; amended Pub. L. 97-354, §5(a)(38), Oct. 19, 1982, 96 Stat. 1696; Pub. L. 97-448, title I, §105(c)(1)-(3), (5)(A)-(C), Jan. 12, 1983, 96 Stat. 2385, 2386; Pub. L. 98-369, div. A, title I, §§102(a), (b), (e)(1), (5), 104(a), 107(c), (d), title VII, §722(a)(2), July 18, 1984, 98 Stat. 620, 621, 623, 624, 628, 630, 972; Pub. L. 99-514, title XII,

§ 1261(c), Oct. 22, 1986, 100 Stat. 2591; Pub. L. 106-170, title V, § 532(b)(4), Dec. 17, 1999, 113 Stat. 1930; Pub. L. 106-554, § 1(a)(7) [title IV, § 401(g)(1)–(3)], Dec. 21, 2000, 114 Stat. 2763, 2763A-649, 2763A-650; Pub. L. 107-147, title IV, § 416(b)(1), Mar. 9, 2002, 116 Stat. 55; Pub. L. 108-311, title IV, § 405(a)(2), Oct. 4, 2004, 118 Stat. 1188; Pub. L. 109-135, title IV, § 412(*oo*), Dec. 21, 2005, 119 Stat. 2639; Pub. L. 111-203, title XVI, § 1601(a), July 21, 2010, 124 Stat. 2223.)

REFERENCES IN TEXT

Section 3(a)(55) of the Securities Exchange Act of 1934, referred to in subsec. (g)(6)(B), is classified to section 78c(a)(55) of Title 15, Commerce and Trade.

The date of the enactment of this paragraph, referred to in subsec. (g)(6)(B), probably means the date of enactment of Pub. L. 106-554, which amended subsec. (g)(6) generally and which was approved Dec. 21, 2000.

AMENDMENTS

2010—Subsec. (b). Pub. L. 111-203 redesignated first sentence as par. (1), inserted heading, redesignated former pars. (1) to (5) as subpars. (A) to (E), respectively, of par. (1), added par. (2), and struck out concluding provisions which read as follows: “The term ‘section 1256 contract’ shall not include any securities futures contract or option on such a contract unless such contract or option is a dealer securities futures contract.”

2005—Subsec. (f)(1). Pub. L. 109-135 substituted “subsection (e)(2)” for “subsection (e)(2)(C)”.

2004—Subsec. (g)(6). Pub. L. 108-311 added at end of concluding provisions “The Secretary may prescribe regulations regarding the status of options the values of which are determined directly or indirectly by reference to any index which becomes (or ceases to be) a narrow-based security index (as so defined).”

2002—Subsec. (f)(5). Pub. L. 107-147 added par. (5).

2000—Subsec. (b). Pub. L. 106-554, § 1(a)(7) [title IV, § 401(g)(1)(A)], added par. (5) and concluding provisions.

Subsec. (f)(4). Pub. L. 106-554, § 1(a)(7) [title IV, § 401(g)(2)], inserted “and dealer securities futures contracts” after “dealer equity options” in heading and “, or dealer securities futures contracts,” after “dealer equity options” in introductory provisions.

Subsec. (g)(6). Pub. L. 106-554, § 1(a)(7) [title IV, § 401(g)(3)], amended heading and text of par. (6) generally. Prior to amendment, text read as follows:

“(A) IN GENERAL.—Except as provided in subparagraph (B), the term ‘equity option’ means any option—

“(i) to buy or sell stock, or

“(ii) the value of which is determined directly or indirectly by reference to any stock (or group of stocks) or stock index.

“(B) EXCEPTION FOR CERTAIN OPTIONS REGULATED BY COMMODITIES FUTURES TRADING COMMISSION.—The term ‘equity option’ does not include any option with respect to any group of stocks or stock index if—

“(i) there is in effect a designation by the Commodities Futures Trading Commission of a contract market for a contract based on such group of stocks or index, or

“(ii) the Secretary determines that such option meets the requirements of law for such a designation.”

Subsec. (g)(9). Pub. L. 106-554, § 1(a)(7) [title IV, § 401(g)(1)(B)], added par. (9).

1999—Subsec. (e)(2). Pub. L. 106-170 reenacted heading without change and amended text generally. Prior to amendment, text read as follows: “For purposes of this subsection, the term ‘hedging transaction’ means any transaction if—

“(A) such transaction is entered into by the taxpayer in the normal course of the taxpayer’s trade or business primarily—

“(i) to reduce risk of price change or currency fluctuations with respect to property which is held or to be held by the taxpayer, or

“(ii) to reduce risk of interest rate or price changes or currency fluctuations with respect to borrowings made or to be made, or obligations incurred or to be incurred, by the taxpayer,

“(B) the gain or loss on such transactions is treated as ordinary income or loss, and

“(C) before the close of the day on which such transaction was entered into (or such earlier time as the Secretary may prescribe by regulations), the taxpayer clearly identifies such transaction as being a hedging transaction.”

1986—Subsec. (e)(4), (5). Pub. L. 99-514 redesignated par. (5) as (4) and struck out former par. (4), special rule for banks, which read as follows: “In the case of a bank (as defined in section 581), subparagraph (A) of paragraph (2) shall be applied without regard to clause (i) or (ii) thereof.”

1984—Pub. L. 98-369, § 102(e)(5), substituted “Section 1256 contracts” for “Regulated futures contracts” in section catchline.

Subsec. (a)(1), (3), (4). Pub. L. 98-369, § 102(a)(1), substituted “section 1256 contract” for “regulated futures contract” and “section 1256 contracts” for “regulated futures contracts” wherever appearing.

Subsec. (b). Pub. L. 98-369, § 102(a)(2), in par. (1), substituted “any regulated futures contract” for “with respect to which the amount required to be deposited and the amount which may be withdrawn depends on the system of marking to market; and”, in par. (2), substituted “any foreign currency contract,” for “which is traded on or subject to the rules of a domestic board of trade designated as a contract market by the Commodity Futures Trading Commission or of any board of trade or exchange which the Secretary determines has rules adequate to carry out the purposes of this section. Such term includes any foreign currency contract.”, and added pars. (3) and (4).

Subsec. (c)(1). Pub. L. 98-369, § 102(a)(1)(A), (e)(1)(A), substituted “section 1256 contracts” for “regulated futures contracts”, and “by taking or making delivery, by exercise or being exercised, by assignment or being assigned, by lapse,” for “by taking or making delivery.”.

Subsec. (c)(2). Pub. L. 98-369, § 102(e)(1)(C), substituted “takes delivery on or exercises” for “takes delivery on” in heading.

Subsec. (c)(2)(A). Pub. L. 98-369, § 102(a)(1)(B), substituted “section 1256 contracts” for “regulated futures contracts”.

Subsec. (c)(2)(B). Pub. L. 98-369, § 102(e)(1)(B), substituted “takes delivery under or exercises” for “takes delivery under”.

Subsec. (d)(1), (4)(A). Pub. L. 98-369, § 102(a)(1)(B), substituted “section 1256 contracts” for “regulated futures contracts”.

Subsec. (d)(4)(B). Pub. L. 98-369, § 102(a)(1)(A), substituted “section 1256 contract” for “regulated futures contract”.

Pub. L. 98-369, § 107(c), inserted “(or such earlier time as the Secretary may prescribe by regulations)”.

Subsec. (e)(2)(C). Pub. L. 98-369, § 107(d), inserted “(or such earlier time as the Secretary may prescribe by regulations)”.

Subsec. (e)(5). Pub. L. 98-369, § 104(a), added par. (5).

Subsec. (f)(3), (4). Pub. L. 98-369, § 102(b), added pars. (3) and (4).

Subsec. (g). Pub. L. 98-369, § 102(a)(3), in amending subsec. (g) generally, inserted provisions relating to regulated futures contracts as par. (1), redesignated former pars. (1) and (2) as subpars. (A) and (B), respectively, of par. (2), and added pars. (3) to (8).

Subsec. (g)(1)(A). Pub. L. 98-369, § 722(a)(2), inserted “, or the settlement of which depends on the value of,” after “delivery of”.

1983—Subsec. (b). Pub. L. 97-448, § 105(c)(5)(A), (B), struck out par. (1) which related to contracts requiring delivery of personal property (as defined in section 1092(d)(1)) or an interest in such property, redesignated pars. (2) and (3) as (1) and (2), respectively, and inserted last sentence providing that such term includes any foreign currency contract.

Subsec. (c). Pub. L. 97-448, § 105(c)(1), inserted “, etc.” after “Terminations” in heading and, in text, designated existing first and second sentences as pars. (1) and (3), respectively, added par. (2), inserted “(or transfer)” after “termination” and “(or rights)” after “obligation” in par. (1) as so designated, and substituted “this subsection” for “the preceding sentence” and inserted “(or transfer)” after “termination” in par. (3) as so designated.

Subsec. (d)(4)(B). Pub. L. 97-448, § 105(c)(2), substituted “day on which the first regulated futures contract forming part of the straddle is acquired” for “day on which such position is acquired”.

Subsec. (e)(3)(C)(v). Pub. L. 97-448, § 105(c)(3), inserted “(by regulations or otherwise)” after “determines”.

Subsec. (g). Pub. L. 97-448, § 105(c)(5)(C), added subsec. (g).

1982—Subsec. (e)(3)(B). Pub. L. 97-354 substituted “an S corporation” for “an electing small business corporation within the meaning of section 1371(b)”.

EFFECTIVE DATE OF 2010 AMENDMENT

Amendment by Pub. L. 111-203 effective 1 day after July 21, 2010, except as otherwise provided, see section 4 of Pub. L. 111-203, set out as a note under section 5301 of Title 12, Banks and Banking.

Pub. L. 111-203, title XVI, § 1601(b), July 21, 2010, 124 Stat. 2223, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after the date of the enactment of this Act [July 21, 2010].”

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-311 effective as if included in section 401 of the Community Renewal Tax Relief Act of 2000 [H.R. 5662, as enacted by Pub. L. 106-554], see section 405(b) of Pub. L. 108-311, set out as a note under section 1234B of this title.

EFFECTIVE DATE OF 2002 AMENDMENT

Pub. L. 107-147, title IV, § 416(b)(2), Mar. 9, 2002, 116 Stat. 55, provided that: “The amendment made by this subsection [amending this section] shall take effect as if included in section 5075 of the Technical and Miscellaneous Revenue Act of 1988 [Pub. L. 100-647].”

EFFECTIVE DATE OF 1999 AMENDMENT

Amendment by Pub. L. 106-170 applicable to any instrument held, acquired, or entered into, any transaction entered into, and supplies held or acquired on or after Dec. 17, 1999, see section 532(d) of Pub. L. 106-170, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, with certain exceptions and qualifications, see section 1261(e) of Pub. L. 99-514, set out as an Effective Date note under section 985 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Section 102(f)-(j) of Pub. L. 98-369, as amended by Pub. L. 99-514, § 2, title XVIII, § 1808(a)(1), Oct. 22, 1986, 100 Stat. 2095, 2817, provided that:

“(f) EFFECTIVE DATES.—

“(1) IN GENERAL.—Except as otherwise provided in this subsection or subsection (g), the amendments made by this section [amending this section, sections 263, 1092, 1212, 1234A, 1362, 1374, and 1402 of this title, and section 411 of Title 42, The Public Health and Welfare, and enacting provisions set out as a note under section 1362 of this title] shall apply to positions established after the date of the enactment of this Act [July 18, 1984], in taxable years ending after such date.

“(2) SPECIAL RULE FOR OPTIONS ON REGULATED FUTURES CONTRACTS.—In the case of any option with respect to a regulated futures contract (within the

meaning of section 1256 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954]), the amendments made by this section shall apply to positions established after October 31, 1983, in taxable years ending after such date.

“(3) SPECIAL RULE FOR SELF-EMPLOYMENT TAX.—Except as provided in subsection (g)(2), the amendments made by subsection (c) [amending section 1402 of this title and section 411 of Title 42] shall apply to taxable years beginning after the date of the enactment of this Act [July 18, 1984].

“(4) GAINS OR LOSSES FROM CERTAIN TERMINATIONS.—The amendment made by subsection (d)(9) [probably means subsec. (e)(9), which amended section 1234A of this title] shall apply as if included in the amendment made by section 505(a) [probably means section 507(a)] of the Economic Recovery Tax Act of 1981 [Pub. L. 97-34], as amended by section 105(e) of the Technical Corrections Act of 1982 [Pub. L. 97-448].

“(g) ELECTIONS WITH RESPECT TO PROPERTY HELD ON OR BEFORE THE DATE OF THE ENACTMENT OF THIS ACT.—At the election of the taxpayer—

“(1) the amendments made by this section [amending this section, sections 263, 1092, 1212, 1234A, 1362, 1374, and 1402 of this title, and section 411 of Title 42, The Public Health and Welfare, and enacting provisions set out as a note under section 1362 of this title] shall apply to all section 1256 contracts held by the taxpayer on the date of the enactment of this Act [July 18, 1984], effective for periods after such date in taxable years ending after such date, or

“(2) in lieu of an election under paragraph (1), the amendments made by this section shall apply to all section 1256 contracts held by the taxpayer at any time during the taxable year of the taxpayer which includes the date of the enactment of this Act.

“(h) ELECTIONS FOR INSTALLMENT PAYMENT OF TAX ATTRIBUTABLE TO STOCK OPTIONS.—

“(1) IN GENERAL.—If the taxpayer makes an election under subsection (g)(2) and under this subsection—

“(A) the taxpayer may pay part or all the tax for the taxable year referred to in subsection (g)(2) in 2 or more (but not exceeding 5) equal installments, and

“(B) the maximum amount of tax which may be paid in installments under this subsection shall be the excess of—

“(i) the tax for such taxable year determined by taking into account subsection (g)(2), over

“(ii) the tax for such taxable year determined by taking into account subsection (g)(2) and by treating—

“(I) all section 1256 contracts which are stock options, and

“(II) any stock which was a part of a straddle including any such stock options,

as having been acquired for a purchase price equal to their fair market value on the last business day of the preceding taxable year. Stock options and stock shall be taken into account under subparagraph (B)(ii) only if such options or stock were held on the last day of the preceding taxable year and only if income on such options or stock would have been ordinary income if such options or stock were sold at a gain on such last day.

“(2) DATE FOR PAYMENT OF INSTALLMENT.—

“(A) If an election is made under this subsection, the first installment under paragraph (1) shall be paid on or before the due date for filing the return for the taxable year described in paragraph (1), and each succeeding installment shall be paid on or before the date which is 1 year after the date prescribed for payment of the preceding installment.

“(B) If a bankruptcy case or insolvency proceeding involving the taxpayer is commenced before the final installment is paid, the total amount of any unpaid installments shall be treated as due and payable on the day preceding the day on which such case or proceeding is commenced.

“(3) INTEREST IMPOSED.—For purposes of section 6601 of the Internal Revenue Code of 1986, the time for

payment of any tax with respect to which an election is made under this subsection shall be determined without regard to this subsection.

“(4) FORM OF ELECTION.—An election under this subsection shall be made not later than the time for filing the return for the taxable year described in paragraph (1) and shall be made in the manner and form required by regulations prescribed by Secretary of the Treasury or his delegate. The election shall set forth—

“(A) the amount determined under paragraph (1)(B) and the number of installments elected by the taxpayer,

“(B) the property described in paragraph (1)(B)(ii), and the date on which such property was acquired,

“(C) the fair market value of the property described in paragraph (1)(B)(ii) on the last business day of the taxable year preceding the taxable year described in paragraph (1), and

“(D) such other information for purposes of carrying out the provisions of this subsection as may be required by such regulations.

“(5) DELAY OF IDENTIFICATION REQUIREMENT.—Section 1256(e)(2)(C) of the Internal Revenue Code of 1986 shall not apply to any stock option or stock acquired on or before the 60th day after the date of the enactment of this Act [July 18, 1984].

“(i) DEFINITIONS.—For purposes of subsections (g) and (h)—

“(1) SECTION 1256 CONTRACT.—The term ‘section 1256 contract’ has the meaning given to such term by section 1256(b) of the Internal Revenue Code of 1986 (as amended by this section).

“(2) STOCK OPTION.—The term ‘stock option’ means any option to buy or sell stock.

“(j) COORDINATION OF ELECTION UNDER SUBSECTION (d)(3) WITH ELECTIONS UNDER SUBSECTIONS (g) AND (h).—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to coordinate the election provided by subsection (d)(3) with the elections provided by subsections (g) and (h).”

Section 104(b) of Pub. L. 98-369 provided that: “The amendment made by subsection (a) [amending this section] shall apply to taxable years beginning after December 31, 1984.”

Amendment by section 107(c), (d) of Pub. L. 98-369 applicable to positions entered into after July 18, 1984, in taxable years ending after that date, see section 107(e) of Pub. L. 98-369 set out as a note under section 1092 of this title.

Amendment by section 722(a)(2) of Pub. L. 98-369 effective as if included in the provisions of the Technical Corrections Act of 1984, Pub. L. 97-448, to which such amendment relates, see section 722(a)(6) of Pub. L. 98-369, set out as a note under section 172 of this title.

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by Pub. L. 97-448 effective, except as otherwise provided, as if it had been included in the provision of the Economic Recovery Tax Act of 1981, Pub. L. 97-34, to which such amendment relates, see section 109 of Pub. L. 97-448, set out as a note under section 1 of this title.

Section 105(c)(5)(D) of Pub. L. 97-448, as amended by Pub. L. 99-514, § 2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(i) IN GENERAL.—Except as provided in clauses (ii) and (iii), the amendments made by subparagraphs (B) and (C) [amending this section] shall apply only with respect to contracts entered into after May 11, 1982.

“(ii) ELECTION BY TAXPAYER OF RETROACTIVE APPLICATION.—

“(I) RETROACTIVE APPLICATION.—If the taxpayer so elects, the amendments made by subparagraphs (B) and (C) [amending this section] shall apply as if included within the amendments made by title V of the Economic Recovery Tax Act of 1981 [title V of Pub. L. 97-34].

“(II) ADDITIONAL CHOICES WITH RESPECT TO 1981.—If the taxpayer held a foreign currency contract after

December 31, 1980, and before June 24, 1981, and such taxpayer makes an election under subclause (I), such taxpayer may revoke any election made under section 508(c) [set out as an Effective Date note under section 1092 of this title] or 509(a) [set out below] of such Act, and may make an election under section 508(c) or 509(a) of such Act.

“(III) ADDITIONAL CHOICES APPLY TO ALL REGULATED FUTURES CONTRACTS.—Except as provided in subclause (IV), in the case of any taxpayer who makes an election under subclause (I), any election under section 508(c) or 509(a) of such Act or any revocation of such an election shall apply to all regulated futures contracts (including foreign currency contracts).

“(IV) SECTION 509(a)(3) AND (4) NOT TO APPLY TO FOREIGN CURRENCY CONTRACTS.—Paragraphs (3) and (4) of section 509(a) of such Act shall not apply to any foreign currency contract.

“(V) TIME FOR MAKING ELECTION OR REVOCATION.—Any election under subclause (I) and any election or revocation under subclause (II) may be made only within the 90-day period beginning on the date of the enactment of this Act [Jan. 12, 1983]. Any such action, once taken, shall be irrevocable.

“(VI) DEFINITIONS.—For purposes of this clause, the terms ‘regulated futures contract’ and ‘foreign currency contract’ have the same respective meanings as when used in section 1256 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as amended by this Act).

“(iii) ELECTION BY TAXPAYER WITH RESPECT TO POSITIONS HELD DURING TAXABLE YEARS ENDING AFTER MAY 11, 1982.—In lieu of the election under clause (ii), a taxpayer may elect to have the amendments made by subparagraphs (B) and (C) [amending subsec. (b) of this section to include foreign currency contracts and enacting subsec. (g) of this section, respectively] applied to all positions held in taxable years ending after May 11, 1982, except that the provisions of section 509(a)(3) and (4) of the Economic Recovery Tax Act of 1981 [set out below] shall not apply.”

EFFECTIVE DATE OF 1982 AMENDMENT

Amendment by Pub. L. 97-354 applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as an Effective Date note under section 1361 of this title.

EFFECTIVE DATE

Section (other than subsec. (e)(2)(C)) applicable to property acquired and positions established by the taxpayer after June 23, 1981, in taxable years ending after such date, subsec. (e)(2)(C) of this section applicable to property acquired and positions established by the taxpayer after Dec. 31, 1981, in taxable years ending after such date, and section applicable when so elected with respect to property held on June 23, 1981, see section 508 of Pub. L. 97-34, set out as a note under section 1092 of this title.

DEADLINE FOR DETERMINATION

Pub. L. 106-554, § 1(a)(7) [title IV, § 401(g)(4)], Dec. 21, 2000, 114 Stat. 2763, 2763A-650, provided that: “The Secretary of the Treasury or his delegate shall make the determinations under section 1256(g)(9)(B) of the Internal Revenue Code of 1986, as added by this Act, not later than July 1, 2001.”

ELECTION FOR EXTENSION OF TIME FOR PAYMENT AND APPLICATION OF THIS SECTION FOR THE TAXABLE YEAR INCLUDING JUNE 23, 1981

Section 509 of Pub. L. 97-34, as amended by Pub. L. 97-448, title I, § 105(c)(6), Jan. 12, 1983, 96 Stat. 2387; Pub. L. 99-514, § 2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(a) ELECTION.—

“(1) IN GENERAL.—In the case of any taxable year beginning before June 23, 1981, and ending after June 22, 1981, the taxpayer may elect, in lieu of any election under section 508(c) [set out as an Effective Date

note under section 1092 of this title], to have this section apply to all regulated futures contracts held during such taxable year.

“(2) APPLICATION OF SECTION 1256.—If a taxpayer elects to have the provisions of this section apply to the taxable year described in paragraph (1).—

“(A) the provisions of section 1256 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (other than section 1256(e)(2)(C)) shall apply to regulated futures contracts held by the taxpayer at any time during such taxable year, and

“(B) for purposes of determining the rate of tax applicable to gains and losses from regulated futures contracts held at any time during such year, such gains and losses shall be treated as gain or loss from a sale or exchange occurring in a taxable year beginning in 1982.

“(3) DETERMINATION OF DEFERRED TAX LIABILITY.—If the taxpayer makes an election under this subsection.—

“(A) the taxpayer may pay part or all of the tax for such year in two or more (but not exceeding five) equal installments;

“(B) the maximum amount of tax which may be paid in installments under this section shall be the excess of—

“(i) the tax for such year, determined by taking into account paragraph (2), over

“(ii) the tax for such year, determined by taking into account paragraph (2) and by treating all regulated futures contracts which were held by the taxpayer on the first day of the taxable year described in paragraph (1), and which were acquired before the first day of such taxable year, as having been acquired for a purchase price equal to their fair market value on the last business day of the preceding taxable year.

“(4) DATE FOR PAYMENT OF INSTALLMENT.—

“(A) If an election is made under this subsection, the first installment under subsection (a)(3)(A) shall be paid on or before the due date for filing the return for the taxable year described in paragraph (1), and each succeeding installment shall be paid on or before the date which is one year after the date prescribed for payment of the preceding installment.

“(B) If a bankruptcy case or insolvency proceeding involving the taxpayer is commenced before the final installment is paid, the total amount of any unpaid installments shall be treated as due and payable on the day preceding the day on which such case or proceeding is commenced.

“(5) INTEREST IMPOSED.—For purposes of section 6601 of the Internal Revenue Code of 1986, the time for payment of any tax with respect to which an election is made under this subsection shall be determined without regard to this subsection.

“(b) FORM OF ELECTION.—An election under this section shall be made not later than the time for filing the return for the taxable year described in subsection (a)(1) and shall be made in the manner and form required by regulations prescribed by the Secretary. The election shall set forth—

“(1) the amount determined under subsection (a)(3)(B) and the number of installments elected by the taxpayer,

“(2) each regulated futures contract held by the taxpayer on the first day of the taxable year described in subsection (a)(1), and the date such contract was acquired,

“(3) the fair market value on the last business day of the preceding taxable year for each regulated futures contract described in paragraph (2), and

“(4) such other information for purposes of carrying out the provisions of this section as may be required by such regulations.”

§ 1257. Disposition of converted wetlands or highly erodible croplands

(a) Gain treated as ordinary income

Any gain on the disposition of converted wetland or highly erodible cropland shall be treated as ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle, except that this section shall not apply to the extent such gain is recognized as ordinary income under any other provision of this part.

(b) Loss treated as long-term capital loss

Any loss recognized on the disposition of converted wetland or highly erodible cropland shall be treated as a long-term capital loss.

(c) Definitions

For purposes of this section—

(1) Converted wetland

The term “converted wetland” means any converted wetland (as defined in section 1201(4)¹ of the Food Security Act of 1985 (16 U.S.C. 3801(4))) held—

(A) by the person whose activities resulted in such land being converted wetland, or

(B) by any other person who at any time used such land for farming purposes.

(2) Highly erodible cropland

The term “highly erodible cropland” means any highly erodible cropland (as defined in section 1201(6)¹ of the Food Security Act of 1985 (16 U.S.C. 3801(6))), if at any time the taxpayer used such land for farming purposes (other than the grazing of animals).

(3) Treatment of successors

If any land is converted wetland or highly erodible cropland in the hands of any person, such land shall be treated as converted wetland or highly erodible cropland in the hands of any other person whose adjusted basis in such land is determined (in whole or in part) by reference to the adjusted basis of such land in the hands of such person.

(d) Special rules

Under regulations prescribed by the Secretary, rules similar to the rules applicable under section 1245 shall apply for purposes of subsection (a). For purposes of sections 170(e) and 751(c), amounts treated as ordinary income under subsection (a) shall be treated in the same manner as amounts treated as ordinary income under section 1245.

(Added Pub. L. 99-514, title IV, § 403(a), Oct. 22, 1986, 100 Stat. 2222; amended Pub. L. 108-27, title III, § 302(e)(4)(B)(ii), May 28, 2003, 117 Stat. 764.)

AMENDMENT OF SECTION

For termination of amendment by section 303 of Pub. L. 108-27, see Effective and Termination Dates of 2003 Amendment note below.

REFERENCES IN TEXT

Section 1201(4) of the Food Security Act of 1985 (16 U.S.C. 3801(4)) and section 1201(6) of the Food Security Act of 1985 (16 U.S.C. 3801(6)), referred to in subsec.

¹ See References in Text note below.

(c)(1), (2), probably are references to section 1201(a)(4) and 1201(a)(6) of that Act (16 U.S.C. 3801(a)(4), (6)). Section 1201 of the Food Security Act of 1985 was subsequently amended, and subssecs. (a)(4) and (a)(6) of section 1201 no longer define the terms “converted wetland” and “highly erodible cropland”, respectively. However, such terms are defined elsewhere in that section.

AMENDMENTS

2003—Subsec. (d). Pub. L. 108-27, §§302(e)(4)(B)(ii), 303, temporarily struck out “, 341(e)(12),” after “170(e)”. See Effective and Termination Dates of 2003 Amendment note below.

EFFECTIVE AND TERMINATION DATES OF 2003 AMENDMENT

Amendment by Pub. L. 108-27 applicable, except as otherwise provided, to taxable years beginning after Dec. 31, 2002, see section 302(f) of Pub. L. 108-27, set out as a note under section 1 of this title.

Amendment by Pub. L. 108-27 inapplicable to taxable years beginning after Dec. 31, 2012, and the Internal Revenue Code of 1986 to be applied and administered to such years as if such amendment had never been enacted, see section 303 of Pub. L. 108-27, as amended, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section 403(c) of Pub. L. 99-514 provided that: “The amendments made by this section [enacting this section] shall apply to dispositions of converted wetland or highly erodible cropland (as defined in section 1257(c) of the Internal Revenue Code of 1986 as added by this section) first used for farming after March 1, 1986, in taxable years ending after that date.”

§ 1258. Rec characterization of gain from certain financial transactions

(a) General rule

In the case of any gain—

- (1) which (but for this section) would be treated as gain from the sale or exchange of a capital asset, and
- (2) which is recognized on the disposition or other termination of any position which was held as part of a conversion transaction,

such gain (to the extent such gain does not exceed the applicable imputed income amount) shall be treated as ordinary income.

(b) Applicable imputed income amount

For purposes of subsection (a), the term “applicable imputed income amount” means, with respect to any disposition or other termination referred to in subsection (a), an amount equal to—

- (1) the amount of interest which would have accrued on the taxpayer’s net investment in the conversion transaction for the period ending on the date of such disposition or other termination (or, if earlier, the date on which the requirements of subsection (c) ceased to be satisfied) at a rate equal to 120 percent of the applicable rate, reduced by
- (2) the amount treated as ordinary income under subsection (a) with respect to any prior disposition or other termination of a position which was held as a part of such transaction.

The Secretary shall by regulations provide for such reductions in the applicable imputed income amount as may be appropriate by reason of amounts capitalized under section 263(g), ordinary income received, or otherwise.

(c) Conversion transaction

For purposes of this section, the term “conversion transaction” means any transaction—

- (1) substantially all of the taxpayer’s expected return from which is attributable to the time value of the taxpayer’s net investment in such transaction, and
- (2) which is—
 - (A) the holding of any property (whether or not actively traded), and the entering into a contract to sell such property (or substantially identical property) at a price determined in accordance with such contract, but only if such property was acquired and such contract was entered into on a substantially contemporaneous basis,
 - (B) an applicable straddle,
 - (C) any other transaction which is marketed or sold as producing capital gains from a transaction described in paragraph (1), or
 - (D) any other transaction specified in regulations prescribed by the Secretary.

(d) Definitions and special rules

For purposes of this section—

(1) Applicable straddle

The term “applicable straddle” means any straddle (within the meaning of section 1092(c)).

(2) Applicable rate

The term “applicable rate” means—

- (A) the applicable Federal rate determined under section 1274(d) (compounded semi-annually) as if the conversion transaction were a debt instrument, or
- (B) if the term of the conversion transaction is indefinite, the Federal short-term rates in effect under section 6621(b) during the period of the conversion transaction (compounded daily).

(3) Treatment of built-in losses

(A) In general

If any position with a built-in loss becomes part of a conversion transaction—

- (i) for purposes of applying this subtitle to such position for periods after such position becomes part of such transaction, such position shall be taken into account at its fair market value as of the time it became part of such transaction, except that
- (ii) upon the disposition or other termination of such position in a transaction in which gain or loss is recognized, such built-in loss shall be recognized and shall have a character determined without regard to this section.

(B) Built-in loss

For purposes of subparagraph (A), the term “built-in loss” means the loss (if any) which would have been realized if the position had been disposed of or otherwise terminated at its fair market value as of the time such position became part of the conversion transaction.

(4) Position taken into account at fair market value

In determining the taxpayer’s net investment in any conversion transaction, there

shall be included the fair market value of any position which becomes part of such transaction (determined as of the time such position became part of such transaction).

(5) Special rule for options dealers and commodities traders

(A) In general

Subsection (a) shall not apply to transactions—

- (i) of an options dealer in the normal course of the dealer's trade or business of dealing in options, or
- (ii) of a commodities trader in the normal course of the trader's trade or business of trading section 1256 contracts.

(B) Definitions

For purposes of this paragraph—

(i) Options dealer

The term “options dealer” has the meaning given such term by section 1256(g)(8).

(ii) Commodities trader

The term “commodities trader” means any person who is a member (or, except as otherwise provided in regulations, is entitled to trade as a member) of a domestic board of trade which is designated as a contract market by the Commodity Futures Trading Commission.

(C) Limited partners and limited entrepreneurs

In the case of any gain from a transaction recognized by an entity which is allocable to a limited partner or limited entrepreneur (within the meaning of section 464(e)(2)), subparagraph (A) shall not apply if—

- (i) substantially all of the limited partner's (or limited entrepreneur's) expected return from the entity is attributable to the time value of the partner's (or entrepreneur's) net investment in such entity,
- (ii) the transaction (or the interest in the entity) was marketed or sold as producing capital gains treatment from a transaction described in subsection (c)(1), or
- (iii) the transaction (or the interest in the entity) is a transaction (or interest) specified in regulations prescribed by the Secretary.

(Added Pub. L. 103-66, title XIII, §13206(a)(1), Aug. 10, 1993, 107 Stat. 462; amended Pub. L. 108-357, title VIII, §888(c)(2), Oct. 22, 2004, 118 Stat. 1643.)

AMENDMENTS

2004—Subsec. (d)(1). Pub. L. 108-357 struck out “; except that the term ‘personal property’ shall include stock” before period at end.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to positions established on or after Oct. 22, 2004, see section 888(e) of Pub. L. 108-357, set out as a note under section 246 of this title.

EFFECTIVE DATE

Section 13206(a)(3) of Pub. L. 103-66, as amended by Pub. L. 104-188, title I, §1703(n)(11), Aug. 20, 1996, 110

Stat. 1877, provided that: “The amendments made by this subsection [enacting this section] shall apply to conversion transactions entered into after April 30, 1993.”

§ 1259. Constructive sales treatment for appreciated financial positions

(a) In general

If there is a constructive sale of an appreciated financial position—

- (1) the taxpayer shall recognize gain as if such position were sold, assigned, or otherwise terminated at its fair market value on the date of such constructive sale (and any gain shall be taken into account for the taxable year which includes such date), and
- (2) for purposes of applying this title for periods after the constructive sale—

(A) proper adjustment shall be made in the amount of any gain or loss subsequently realized with respect to such position for any gain taken into account by reason of paragraph (1), and

(B) the holding period of such position shall be determined as if such position were originally acquired on the date of such constructive sale.

(b) Appreciated financial position

For purposes of this section—

(1) In general

Except as provided in paragraph (2), the term “appreciated financial position” means any position with respect to any stock, debt instrument, or partnership interest if there would be gain were such position sold, assigned, or otherwise terminated at its fair market value.

(2) Exceptions

The term “appreciated financial position” shall not include—

- (A) any position with respect to debt if—

- (i) the position unconditionally entitles the holder to receive a specified principal amount,
- (ii) the interest payments (or other similar amounts) with respect to such position meet the requirements of clause (i) of section 860G(a)(1)(B), and
- (iii) such position is not convertible (directly or indirectly) into stock of the issuer or any related person,

(B) any hedge with respect to a position described in subparagraph (A), and

(C) any position which is marked to market under any provision of this title or the regulations thereunder.

(3) Position

The term “position” means an interest, including a futures or forward contract, short sale, or option.

(c) Constructive sale

For purposes of this section—

(1) In general

A taxpayer shall be treated as having made a constructive sale of an appreciated financial position if the taxpayer (or a related person)—

(A) enters into a short sale of the same or substantially identical property,

(B) enters into an offsetting notional principal contract with respect to the same or substantially identical property,

(C) enters into a futures or forward contract to deliver the same or substantially identical property,

(D) in the case of an appreciated financial position that is a short sale or a contract described in subparagraph (B) or (C) with respect to any property, acquires the same or substantially identical property, or

(E) to the extent prescribed by the Secretary in regulations, enters into 1 or more other transactions (or acquires 1 or more positions) that have substantially the same effect as a transaction described in any of the preceding subparagraphs.

(2) Exception for sales of nonpublicly traded property

A taxpayer shall not be treated as having made a constructive sale solely because the taxpayer enters into a contract for sale of any stock, debt instrument, or partnership interest which is not a marketable security (as defined in section 453(f)) if the contract settles within 1 year after the date such contract is entered into.

(3) Exception for certain closed transactions

(A) In general

In applying this section, there shall be disregarded any transaction (which would otherwise cause a constructive sale) during the taxable year if—

(i) such transaction is closed on or before the 30th day after the close of such taxable year,

(ii) the taxpayer holds the appreciated financial position throughout the 60-day period beginning on the date such transaction is closed, and

(iii) at no time during such 60-day period is the taxpayer's risk of loss with respect to such position reduced by reason of a circumstance which would be described in section 246(c)(4) if references to stock included references to such position.

(B) Treatment of certain closed transactions where risk of loss on appreciated financial position diminished

If—

(i) a transaction, which would otherwise cause a constructive sale of an appreciated financial position, is closed during the taxable year or during the 30 days thereafter, and

(ii) another transaction is entered into during the 60-day period beginning on the date the transaction referred to in clause (i) is closed—

(I) which would (but for this subparagraph) cause the requirement of subparagraph (A)(iii) not to be met with respect to the transaction described in clause (i) of this subparagraph,

(II) which is closed on or before the 30th day after the close of the taxable year in which the transaction referred to in clause (i) occurs, and

(III) which meets the requirements of clauses (ii) and (iii) of subparagraph (A),

the transaction referred to in clause (ii) shall be disregarded for purposes of determining whether the requirements of subparagraph (A)(iii) are met with respect to the transaction described in clause (i).

(4) Related person

A person is related to another person with respect to a transaction if—

(A) the relationship is described in section 267(b) or 707(b), and

(B) such transaction is entered into with a view toward avoiding the purposes of this section.

(d) Other definitions

For purposes of this section—

(1) Forward contract

The term “forward contract” means a contract to deliver a substantially fixed amount of property (including cash) for a substantially fixed price.

(2) Offsetting notional principal contract

The term “offsetting notional principal contract” means, with respect to any property, an agreement which includes—

(A) a requirement to pay (or provide credit for) all or substantially all of the investment yield (including appreciation) on such property for a specified period, and

(B) a right to be reimbursed for (or receive credit for) all or substantially all of any decline in the value of such property.

(e) Special rules

(1) Treatment of subsequent sale of position which was deemed sold

If—

(A) there is a constructive sale of any appreciated financial position,

(B) such position is subsequently disposed of, and

(C) at the time of such disposition, the transaction resulting in the constructive sale of such position is open with respect to the taxpayer or any related person,

solely for purposes of determining whether the taxpayer has entered into a constructive sale of any other appreciated financial position held by the taxpayer, the taxpayer shall be treated as entering into such transaction immediately after such disposition. For purposes of the preceding sentence, an assignment or other termination shall be treated as a disposition.

(2) Certain trust instruments treated as stock

For purposes of this section, an interest in a trust which is actively traded (within the meaning of section 1092(d)(1)) shall be treated as stock unless substantially all (by value) of the property held by the trust is debt described in subsection (b)(2)(A).

(3) Multiple positions in property

If a taxpayer holds multiple positions in property, the determination of whether a specific transaction is a constructive sale and, if

so, which appreciated financial position is deemed sold shall be made in the same manner as actual sales.

(f) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

(Added Pub. L. 105-34, title X, § 1001(a), Aug. 5, 1997, 111 Stat. 903; amended Pub. L. 105-206, title VI, § 6010(a)(1), (2), July 22, 1998, 112 Stat. 812, 813; Pub. L. 108-311, title IV, § 406(e), Oct. 4, 2004, 118 Stat. 1189.)

AMENDMENTS

2004—Subsec. (c)(2). Pub. L. 108-311, § 406(e)(1), substituted “A taxpayer shall not be treated as having made a constructive sale solely because the taxpayer enters into a contract” for “The term ‘constructive sale’ shall not include any contract”.

Subsec. (c)(3)(A). Pub. L. 108-311, § 406(e)(2), substituted “cause a constructive sale” for “be treated as a constructive sale” in introductory provisions.

Subsec. (c)(3)(A)(i). Pub. L. 108-311, § 406(e)(3), substituted “on or before” for “before the end of”.

Subsec. (c)(3)(B). Pub. L. 108-311, § 406(e)(7), substituted “certain closed transactions where risk of loss on appreciated financial position diminished” for “positions which are reestablished” in heading.

Subsec. (c)(3)(B)(i). Pub. L. 108-311, § 406(e)(2), substituted “cause a constructive sale” for “be treated as a constructive sale”.

Subsec. (c)(3)(B)(ii). Pub. L. 108-311, § 406(e)(4), struck out “substantially similar” after “another” in introductory provisions.

Subsec. (c)(3)(B)(ii)(I). Pub. L. 108-311, § 406(e)(5), amended subcl. (I) generally. Prior to amendment, subcl. (I) read as follows: “which also would otherwise be treated as a constructive sale of such position.”

Subsec. (c)(3)(B)(ii)(II). Pub. L. 108-311, § 406(e)(6), inserted “on or” before “before the 30th day”.

1998—Subsec. (b)(2)(A)(i) to (iii). Pub. L. 105-206, § 6010(a)(1)(A), substituted “position” for “debt”.

Subsec. (b)(2)(B), (C). Pub. L. 105-206, § 6010(a)(1)(B), (C), added subpar. (B) and redesignated former subpar. (B) as (C).

Subsec. (d)(1). Pub. L. 105-206, § 6010(a)(2), inserted “(including cash)” after “property”.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-311 effective as if included in the provisions of the Taxpayer Relief Act of 1997, Pub. L. 105-34, to which such amendment relates, see section 406(h) of Pub. L. 108-311, set out as a note under section 55 of this title.

EFFECTIVE DATE OF 1998 AMENDMENT

Amendment by Pub. L. 105-206 effective, except as otherwise provided, as if included in the provisions of the Taxpayer Relief Act of 1997, Pub. L. 105-34, to which such amendment relates, see section 6024 of Pub. L. 105-206, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable to any constructive sale after June 8, 1997, with certain exceptions, see section 1001(d) of Pub. L. 105-34, set out as an Effective Date of 1997 Amendment note under section 475 of this title.

§ 1260. Gains from constructive ownership transactions

(a) In general

If the taxpayer has gain from a constructive ownership transaction with respect to any financial asset and such gain would (without regard

to this section) be treated as a long-term capital gain—

(1) such gain shall be treated as ordinary income to the extent that such gain exceeds the net underlying long-term capital gain, and

(2) to the extent such gain is treated as a long-term capital gain after the application of paragraph (1), the determination of the capital gain rate (or rates) applicable to such gain under section 1(h) shall be determined on the basis of the respective rate (or rates) that would have been applicable to the net underlying long-term capital gain.

(b) Interest charge on deferral of gain recognition

(1) In general

If any gain is treated as ordinary income for any taxable year by reason of subsection (a)(1), the tax imposed by this chapter for such taxable year shall be increased by the amount of interest determined under paragraph (2) with respect to each prior taxable year during any portion of which the constructive ownership transaction was open. Any amount payable under this paragraph shall be taken into account in computing the amount of any deduction allowable to the taxpayer for interest paid or accrued during such taxable year.

(2) Amount of interest

The amount of interest determined under this paragraph with respect to a prior taxable year is the amount of interest which would have been imposed under section 6601 on the underpayment of tax for such year which would have resulted if the gain (which is treated as ordinary income by reason of subsection (a)(1)) had been included in gross income in the taxable years in which it accrued (determined by treating the income as accruing at a constant rate equal to the applicable Federal rate as in effect on the day the transaction closed). The period during which such interest shall accrue shall end on the due date (without extensions) for the return of tax imposed by this chapter for the taxable year in which such transaction closed.

(3) Applicable Federal rate

For purposes of paragraph (2), the applicable Federal rate is the applicable Federal rate determined under section 1274(d) (compounded semiannually) which would apply to a debt instrument with a term equal to the period the transaction was open.

(4) No credits against increase in tax

Any increase in tax under paragraph (1) shall not be treated as tax imposed by this chapter for purposes of determining—

(A) the amount of any credit allowable under this chapter, or

(B) the amount of the tax imposed by section 55.

(c) Financial asset

For purposes of this section—

(1) In general

The term “financial asset” means—

(A) any equity interest in any pass-thru entity, and

- (B) to the extent provided in regulations—
 - (i) any debt instrument, and
 - (ii) any stock in a corporation which is not a pass-thru entity.

(2) Pass-thru entity

For purposes of paragraph (1), the term “pass-thru entity” means—

- (A) a regulated investment company,
- (B) a real estate investment trust,
- (C) an S corporation,
- (D) a partnership,
- (E) a trust,
- (F) a common trust fund,
- (G) a passive foreign investment company (as defined in section 1297 without regard to subsection (d) thereof), and
- (H) a REMIC.

(d) Constructive ownership transaction

For purposes of this section—

(1) In general

The taxpayer shall be treated as having entered into a constructive ownership transaction with respect to any financial asset if the taxpayer—

- (A) holds a long position under a notional principal contract with respect to the financial asset,
- (B) enters into a forward or futures contract to acquire the financial asset,
- (C) is the holder of a call option, and is the grantor of a put option, with respect to the financial asset and such options have substantially equal strike prices and substantially contemporaneous maturity dates, or
- (D) to the extent provided in regulations prescribed by the Secretary, enters into one or more other transactions (or acquires one or more positions) that have substantially the same effect as a transaction described in any of the preceding subparagraphs.

(2) Exception for positions which are marked to market

This section shall not apply to any constructive ownership transaction if all of the positions which are part of such transaction are marked to market under any provision of this title or the regulations thereunder.

(3) Long position under notional principal contract

A person shall be treated as holding a long position under a notional principal contract with respect to any financial asset if such person—

- (A) has the right to be paid (or receive credit for) all or substantially all of the investment yield (including appreciation) on such financial asset for a specified period, and
- (B) is obligated to reimburse (or provide credit for) all or substantially all of any decline in the value of such financial asset.

(4) Forward contract

The term “forward contract” means any contract to acquire in the future (or provide or receive credit for the future value of) any financial asset.

(e) Net underlying long-term capital gain

For purposes of this section, in the case of any constructive ownership transaction with respect

to any financial asset, the term “net underlying long-term capital gain” means the aggregate net capital gain that the taxpayer would have had if—

- (1) the financial asset had been acquired for fair market value on the date such transaction was opened and sold for fair market value on the date such transaction was closed, and
- (2) only gains and losses that would have resulted from the deemed ownership under paragraph (1) were taken into account.

The amount of the net underlying long-term capital gain with respect to any financial asset shall be treated as zero unless the amount thereof is established by clear and convincing evidence.

(f) Special rule where taxpayer takes delivery

Except as provided in regulations prescribed by the Secretary, if a constructive ownership transaction is closed by reason of taking delivery, this section shall be applied as if the taxpayer had sold all the contracts, options, or other positions which are part of such transaction for fair market value on the closing date. The amount of gain recognized under the preceding sentence shall not exceed the amount of gain treated as ordinary income under subsection (a). Proper adjustments shall be made in the amount of any gain or loss subsequently realized for gain recognized and treated as ordinary income under this subsection.

(g) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations—

- (1) to permit taxpayers to mark to market constructive ownership transactions in lieu of applying this section, and
- (2) to exclude certain forward contracts which do not convey substantially all of the economic return with respect to a financial asset.

(Added Pub. L. 106-170, title V, §534(a), Dec. 17, 1999, 113 Stat. 1931; amended Pub. L. 108-357, title IV, §413(c)(23), Oct. 22, 2004, 118 Stat. 1509; Pub. L. 110-172, §11(a)(23), (24)(B), Dec. 29, 2007, 121 Stat. 2486.)

AMENDMENTS

2007—Subsec. (c)(2)(G). Pub. L. 110-172 substituted “subsection (d)” for “subsection (e)” and inserted “and” at end.

2004—Subsec. (c)(2)(H) to (J). Pub. L. 108-357 redesignated subpar. (J) as (H) and struck out former subpars. (H) and (I), which included foreign personal holding company and foreign investment company (as defined in section 1246(b)) within definition of “pass-thru entity”.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108-357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE DATE

Pub. L. 106-170, title V, §534(c), Dec. 17, 1999, 113 Stat. 1934, provided that: “The amendments made by this

section [enacting this section] shall apply to transactions entered into after July 11, 1999.”

PART V—SPECIAL RULES FOR BONDS AND OTHER DEBT INSTRUMENTS

Subpart

- A. Original issue discount.
- B. Market discount on bonds.
- C. Discount on short-term obligations.
- D. Miscellaneous provisions.

AMENDMENTS

1986—Pub. L. 99-514, title XVIII, §1899A(72), Oct. 22, 1986, 100 Stat. 2963, inserted “on bonds” after “discount” in item for subpart B.

SUBPART A—ORIGINAL ISSUE DISCOUNT

Sec.

- 1271. Treatment of amounts received on retirement or sale or exchange of debt instruments.
- 1272. Current inclusion in income of original issue discount.
- 1273. Determination of amount of original issue discount.
- 1274. Determination of issue price in the case of certain debt instruments issued for property.
- 1274A. Special rules for certain transactions where stated principal amount does not exceed \$2,800,000.
- 1275. Other definitions and special rules.

AMENDMENTS

1985—Pub. L. 99-121, title I, §102(d), Oct. 11, 1985, 99 Stat. 509, added item 1274A.

§ 1271. Treatment of amounts received on retirement or sale or exchange of debt instruments

(a) General rule

For purposes of this title—

(1) Retirement

Amounts received by the holder on retirement of any debt instrument shall be considered as amounts received in exchange therefor.

(2) Ordinary income on sale or exchange where intention to call before maturity

(A) In general

If at the time of original issue there was an intention to call a debt instrument before maturity, any gain realized on the sale or exchange thereof which does not exceed an amount equal to—

- (i) the original issue discount, reduced by
- (ii) the portion of original issue discount previously includible in the gross income of any holder (without regard to subsection (a)(7) or (b)(4) of section 1272 (or the corresponding provisions of prior law)),

shall be treated as ordinary income.

(B) Exceptions

This paragraph (and paragraph (2) of subsection (c)) shall not apply to—

- (i) any tax-exempt obligation, or
- (ii) any holder who has purchased the debt instrument at a premium.

(3) Certain short-term Government obligations

(A) In general

On the sale or exchange of any short-term Government obligation, any gain realized

which does not exceed an amount equal to the ratable share of the acquisition discount shall be treated as ordinary income.

(B) Short-term Government obligation

For purposes of this paragraph, the term “short-term Government obligation” means any obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia, which has a fixed maturity date not more than 1 year from the date of issue. Such term does not include any tax-exempt obligation.

(C) Acquisition discount

For purposes of this paragraph, the term “acquisition discount” means the excess of the stated redemption price at maturity over the taxpayer’s basis for the obligation.

(D) Ratable share

For purposes of this paragraph, except as provided in subparagraph (E), the ratable share of the acquisition discount is an amount which bears the same ratio to such discount as—

- (i) the number of days which the taxpayer held the obligation, bears to
- (ii) the number of days after the date the taxpayer acquired the obligation and up to (and including) the date of its maturity.

(E) Election of accrual on basis of constant interest rate

At the election of the taxpayer with respect to any obligation, the ratable share of the acquisition discount is the portion of the acquisition discount accruing while the taxpayer held the obligation determined (under regulations prescribed by the Secretary) on the basis of—

- (i) the taxpayer’s yield to maturity based on the taxpayer’s cost of acquiring the obligation, and
- (ii) compounding daily.

An election under this subparagraph, once made with respect to any obligation, shall be irrevocable.

(4) Certain short-term nongovernment obligations

(A) In general

On the sale or exchange of any short-term nongovernment obligation, any gain realized which does not exceed an amount equal to the ratable share of the original issue discount shall be treated as ordinary income.

(B) Short-term nongovernment obligation

For purposes of this paragraph, the term “short-term nongovernment obligation” means any obligation which—

- (i) has a fixed maturity date not more than 1 year from the date of the issue, and
- (ii) is not a short-term Government obligation (as defined in paragraph (3)(B) without regard to the last sentence thereof).

(C) Ratable share

For purposes of this paragraph, except as provided in subparagraph (D), the ratable share of the original issue discount is an

amount which bears the same ratio to such discount as—

- (i) the number of days which the taxpayer held the obligation, bears to
- (ii) the number of days after the date of original issue and up to (and including) the date of its maturity.

(D) Election of accrual on basis of constant interest rate

At the election of the taxpayer with respect to any obligation, the ratable share of the original issue discount is the portion of the original issue discount accruing while the taxpayer held the obligation determined (under regulations prescribed by the Secretary) on the basis of—

- (i) the yield to maturity based on the issue price of the obligation, and
- (ii) compounding daily.

Any election under this subparagraph, once made with respect to any obligation, shall be irrevocable.

(b) Exception for certain obligations

(1) In general

This section shall not apply to—

- (A) any obligation issued by a natural person before June 9, 1997, and
- (B) any obligation issued before July 2, 1982, by an issuer which is not a corporation and is not a government or political subdivision thereof.

(2) Termination

Paragraph (1) shall not apply to any obligation purchased (within the meaning of section 1272(d)(1)) after June 8, 1997.

(c) Transition rules

(1) Special rule for certain obligations issued before January 1, 1955

Paragraph (1) of subsection (a) shall apply to a debt instrument issued before January 1, 1955, only if such instrument was issued with interest coupons or in registered form, or was in such form on March 1, 1954.

(2) Special rule for certain obligations with respect to which original issue discount not currently includible

(A) In general

On the sale or exchange of debt instruments issued by a government or political subdivision thereof after December 31, 1954, and before July 2, 1982, or by a corporation after December 31, 1954, and on or before May 27, 1969, any gain realized which does not exceed—

- (i) an amount equal to the original issue discount, or
- (ii) if at the time of original issue there was no intention to call the debt instrument before maturity, an amount which bears the same ratio to the original issue discount as the number of complete months that the debt instrument was held by the taxpayer bears to the number of complete months from the date of original issue to the date of maturity,

shall be considered as ordinary income.

(B) Subsection (a)(2)(A) not to apply

Subsection (a)(2)(A) shall not apply to any debt instrument referred to in subparagraph (A) of this paragraph.

(C) Cross reference

For current inclusion of original issue discount, see section 1272.

(d) Double inclusion in income not required

This section and sections 1272 and 1286 shall not require the inclusion of any amount previously includible in gross income.

(Added Pub. L. 98-369, div. A, title I, § 41(a), July 18, 1984, 98 Stat. 531; amended Pub. L. 99-514, title XVIII, § 1803(a)(1)(A), (2), (3), Oct. 22, 1986, 100 Stat. 2791, 2792; Pub. L. 100-647, title I, § 1006(u)(4), Nov. 10, 1988, 102 Stat. 3427; Pub. L. 105-34, title X, § 1003(c)(1), Aug. 5, 1997, 111 Stat. 910.)

AMENDMENTS

1997—Subsec. (b). Pub. L. 105-34 amended heading and text of subsec. (b) generally. Prior to amendment, text read as follows: “This section shall not apply to—

“(1) NATURAL PERSONS.—Any obligation issued by a natural person.

“(2) OBLIGATIONS ISSUED BEFORE JULY 2, 1982, BY CERTAIN ISSUERS.—Any obligation issued before July 2, 1982, by an issuer which—

“(A) is not a corporation, and

“(B) is not a government or political subdivision thereof.”

1988—Subsec. (a)(2)(A)(ii). Pub. L. 100-647 substituted “subsection (a)(7)” for “subsection (a)(6)”.

1986—Subsec. (a)(3)(B). Pub. L. 99-514, § 1803(a)(3), amended subpar. (B) generally. Prior to amendment, subpar. (B) read as follows: “For purposes of this paragraph, the term ‘short-term Government obligation’ means any obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia which is—

“(i) issued on a discount basis, and

“(ii) payable without interest at a fixed maturity date not more than 1 year from the date of issue. Such term does not include any tax-exempt obligation.”

Subsec. (a)(3)(D). Pub. L. 99-514, § 1803(a)(2)(B), inserted “except as provided in subparagraph (E).”

Subsec. (a)(3)(E). Pub. L. 99-514, § 1803(a)(2)(A), added subpar. (E).

Subsec. (a)(4). Pub. L. 99-514, § 1803(a)(1)(A), added par. (4).

EFFECTIVE DATE OF 1997 AMENDMENT

Section 1003(c)(2) of Pub. L. 105-34 provided that: “The amendment made by paragraph (1) [amending this section] shall apply to sales, exchanges, and retirements after the date of enactment of this Act [Aug. 5, 1997].”

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section 44 of subtitle C (§§ 41-44) of title I of division A of Pub. L. 98-369, as amended by Pub. L. 98-612, § 2,

Oct. 31, 1984, 98 Stat. 3182; Pub. L. 99-514, §2, title XVIII, §1803(b), Oct. 22, 1986, 100 Stat. 2095, 2797, provided that:

“(a) GENERAL RULE.—Except as otherwise provided in this section, the amendments made by this subtitle [enacting this section and sections 1272 to 1288 and 6706, amending sections 103A, 163, 165, 249, 341, 405, 409, 453B, 483, 751, 811, 871, 881, 1016, 1037, 1351, 1441, 6049, 7701, and 7805, and repealing sections 1232, 1232A, and 1232B of this title] shall apply to taxable years ending after the date of the enactment of this Act [July 18, 1984].

“(b) TREATMENT OF DEBT INSTRUMENTS RECEIVED IN EXCHANGE FOR PROPERTY.—

“(1) IN GENERAL.—

“(A) Except as otherwise provided in this subsection, section 1274 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as added by section 41) and the amendment made by section 41(b) (relating to amendment of section 483) shall apply to sales or exchanges after December 31, 1984.

“(B) Section 1274 of such Code and the amendment made by section 41(b) shall not apply to any sale or exchange pursuant to a written contract which was binding on March 1, 1984, and at all times thereafter before the sale or exchange.

“(2) REVISION OF SECTION 482 REGULATIONS.—Not later than 180 days after the date of the enactment of this Act [July 18, 1984], the Secretary of the Treasury or his delegate shall modify the safe harbor interest rates applicable under the regulations prescribed under section 482 of the Internal Revenue Code of 1986 so that such rates are consistent with the rates applicable under section 483 of such Code by reason of the amendments made by section 41.

“(3) CLARIFICATION OF INTEREST ACCRUAL; FAIR MARKET VALUE RULE IN CASE OF POTENTIALLY ABUSIVE SITUATIONS.—

“(A) IN GENERAL.—

“(i) CLARIFICATION OF INTEREST ACCRUAL.—In the case of any sale or exchange—

“(I) after March 1, 1984, nothing in section 483 of the Internal Revenue Code of 1986 shall permit any interest to be deductible before the period to which such interest is properly allocable, or

“(II) after June 8, 1984, notwithstanding section 483 of the Internal Revenue Code of 1986 or any other provision of law, no interest shall be deductible before the period to which such interest is properly allocable.

“(ii) FAIR MARKET RULE.—In the case of any sale or exchange after March 1, 1984, such section 483 shall be treated as including provisions similar to the provisions of section 1274(b)(3) of such Code (as added by section 41).

“(B) EXCEPTION FOR BINDING CONTRACTS.—

“(i) Subparagraph (A)(i)(I) shall not apply to any sale or exchange pursuant to a written contract which was binding on March 1, 1984, and at all times thereafter before the sale or exchange.

“(ii) Subparagraph (A)(i)(II) shall not apply to any sale or exchange pursuant to a written contract which was binding on June 8, 1984, and at all times thereafter before the sale or exchange.

“(C) INTEREST ACCRUAL RULE NOT TO APPLY WHERE SUBSTANTIALLY EQUAL ANNUAL PAYMENTS.—Clause (i) of subparagraph (A) shall not apply to any debt instrument with substantially equal annual payments.

“(4) SPECIAL RULES FOR SALES AFTER DECEMBER 31, 1984, AND BEFORE JULY 1, 1985.—

“(A) IN GENERAL.—In the case of any sale or exchange after December 31, 1984, and before July 1, 1985, of property other than new section 38 property—

“(i) sections 483(c)(1)(B) and 1274(c)(3) of the Internal Revenue Code of 1986 shall be applied by substituting the testing rate determined under subparagraph (B) for 110 percent of the applicable Federal rate determined under section 1274(d) of such Code, and

“(ii) sections 483(b) and 1274(b) of such Code shall be applied by substituting the imputation rate determined under subparagraph (C) for 120 percent of the applicable Federal rate determined under section 1274(d) of such Code.

“(B) TESTING RATE.—For purposes of this paragraph—

“(i) IN GENERAL.—The testing rate determined under this subparagraph is the sum of—

“(I) 9 percent, plus

“(II) if the borrowed amount exceeds \$2,000,000, the excess determined under clause (i) multiplied by a fraction the numerator of which is the borrowed amount to the extent it exceeds \$2,000,000, and the denominator of which is the borrowed amount.

“(ii) EXCESS.—For purposes of clause (i), the excess determined under this clause is the excess of 110 percent of the applicable Federal rate determined under section 1274(d) of such Code over 9 percent.

“(C) IMPUTATION RATE.—For purposes of this paragraph—

“(i) IN GENERAL.—The imputation rate determined under this subparagraph is the sum of—

“(I) 10 percent, plus

“(II) if the borrowed amount exceeds \$2,000,000, the excess determined under clause (i) multiplied by a fraction the numerator of which is the borrowed amount to the extent it exceeds \$2,000,000, and the denominator of which is the borrowed amount.

“(ii) EXCESS.—For purposes of clause (i), the excess determined under this clause is the excess of 120 percent of the applicable Federal rate determined under section 1274(d) of such Code over 10 percent.

“(D) BORROWED AMOUNT.—For purposes of this paragraph, the term ‘borrowed amount’ means the stated principal amount.

“(E) AGGREGATION RULES.—For purposes of this paragraph—

“(i) all sales or exchanges which are part of the same transaction (or a series of related transactions) shall be treated as one sale or exchange, and

“(ii) all debt instruments arising from the same transaction (or a series of related transactions) shall be treated as one debt instrument.

“(F) CASH METHOD OF ACCOUNTING.—In the case of any sale or exchange before July 1, 1985, of property (other than new section 38 property) used in the active business of farming and in which the borrowed amount does not exceed \$2,000,000—

“(i) section 1274 of the Internal Revenue Code of 1986 shall not apply, and

“(ii) interest on the obligation issued in connection with such sale or exchange shall be taken into account by both buyer and seller on the cash receipts and disbursements method of accounting. The Secretary of the Treasury or his delegate may by regulation prescribe rules to prevent the mismatching of interest income and interest deductions in connection with obligations on which interest is computed on the cash receipts and disbursements method of accounting.

“(G) CLARIFICATION OF APPLICATION OF THIS PARAGRAPH, ETC.—This paragraph and paragraphs (5), (6), and (7) shall apply only in the case of sales or exchanges to which section 1274 or 483 of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as amended by section 41) applies.

“(5) GENERAL RULE FOR ASSUMPTIONS OF LOANS.—Except as provided in paragraphs (6) and (7), if any person—

“(A) assumes, in connection with the sale or exchange of property, any debt obligation, or

“(B) acquires any property subject to any debt obligation, sections 1274 and 483 of the Internal Revenue Code of 1986 shall apply to such debt obligation by reason of such assumption (or such acquisition).

“(6) EXCEPTION FOR ASSUMPTIONS OF LOANS MADE ON OR BEFORE OCTOBER 15, 1984.—

“(A) IN GENERAL.—If any person—

“(i) assumes, in connection with the sale or exchange of property, any debt obligation described in subparagraph (B) and issued on or before October 15, 1984, or

“(ii) acquires any property subject to any such debt obligation issued on or before October 15, 1984,

sections 1274 and 483 of the Internal Revenue Code of 1986 shall not be applied to such debt obligation by reason of such assumption (or such acquisition) unless the terms and conditions of such debt obligation are modified in connection with the assumption (or acquisition).

“(B) OBLIGATIONS DESCRIBED IN THIS SUBPARAGRAPH.—A debt obligation is described in this subparagraph if such obligation—

“(i) was issued on or before October 15, 1984, and

“(ii) was assumed (or property was taken subject to such obligation) in connection with the sale or exchange of property (including a deemed sale under section 338 (a)) the sales price of which is not greater than \$100,000,000.

“(C) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to effect the purpose of this paragraph and paragraph (5), including regulations relating to tax-exempt obligations, government subsidized loans, or other instruments.

“(D) CERTAIN EXEMPT TRANSACTIONS.—The Secretary shall prescribe regulations under which any transaction shall be exempt from the application of this paragraph if such exemption is not likely to significantly reduce the tax liability of the purchaser by reason of the overstatement of the adjusted basis of the acquired asset.

“(7) EXCEPTION FOR ASSUMPTIONS OF LOANS WITH RESPECT TO CERTAIN PROPERTY.—

“(A) IN GENERAL.—If any person—

“(i) assumes, in connection with the sale or exchange of property described in subparagraph (B), any debt obligation, or

“(ii) acquires any such property subject to any such debt obligation,

sections 1274 and 483 of the Internal Revenue Code of 1986 shall not be applied to such debt obligation by reason of such assumption (or such acquisition) unless the terms and conditions of such debt obligation are modified in connection with the assumption (or acquisition).

“(B) SALES OR EXCHANGES TO WHICH THIS PARAGRAPH APPLIES.—This paragraph shall apply to any of the following sales or exchanges:

“(i) RESIDENCES.—Any sale or exchange of a residence by an individual, an estate, or a testamentary trust, but only if—

“(I) either—

“(aa) such residence on the date of such sale or exchange (or in the case of an estate or testamentary trust, on the date of death of the decedent) was the principal residence (within the meaning of section 1034) of the individual or decedent, or

“(bb) during the 2-year period ending on such date, no substantial portion of such residence was of a character subject to an allowance under this title [probably means the Internal Revenue Code of 1986] for depreciation (or amortization in lieu thereof) in the hands of such individual or decedent, and

“(II) such residence was not at any time, in the hands of such individual, estate, testamentary trust, or decedent, described in section 1221(1) (relating to inventory, etc.).

“(ii) FARMS.—Any sale or exchange by a qualified person of—

“(I) real property which was used as a farm (within the meaning of section 6420(c)(2)) at all

times during the 3-year period ending on the date of such sale or exchange, or

“(II) tangible personal property which was used in the active conduct of the trade or business of farming on such farm and is sold in connection with the sale of such farm,

but only if such property is sold or exchanged for use in the active conduct of the trade or business of farming by the transferee of such property.

“(iii) TRADES OR BUSINESSES.—

“(I) IN GENERAL.—Any sale or exchange by a qualified person of any trade or business.

“(II) APPLICATION WITH SUBPARAGRAPH (B).—This subparagraph shall not apply to any sale or exchange of any property described in subparagraph (B).

“(III) NEW SECTION 38 PROPERTY.—This subparagraph shall not apply to the sale or exchange of any property which, in the hands of the transferee, is new section 38 property.

“(iv) SALE OF BUSINESS REAL ESTATE.—Any sale or exchange of any real property used in an active trade or business by a person who would be a qualified person if he disposed of his entire interest.

This subparagraph shall not apply to any transaction described in the last sentence of paragraph (6)(B) (relating to transaction in excess of \$100,000,000).

“(C) DEFINITIONS.—For purposes of this paragraph—

“(i) QUALIFIED PERSON DEFINED.—The term ‘qualified person’ means—

“(I) a person who—

“(aa) is an individual, estate, or testamentary trust,

“(bb) is a corporation which immediately prior to the date of the sale or exchange has 35 or fewer shareholders, or

“(cc) is a partnership which immediately prior to the date of the sale or exchange has 35 or fewer partners,

“(II) is a 10-percent owner of a farm or a trade or business,

“(III) pursuant to a plan, disposes of—

“(aa) an interest in a farm or farm property, or

“(bb) his entire interest in a trade or business and all substantially similar trades or businesses, and

“(IV) the ownership interest of whom may be readily established by reason of qualified allocations (of the type described in section 168(j)(9)(B), one class of stock, or the like).

“(ii) 10-PERCENT OWNER DEFINED.—The term ‘10-percent owner’ means a person having at least a 10-percent ownership interest, applying the attribution rules of section 318 (other than subsection (a)(4)).

“(iii) TRADE OR BUSINESS DEFINED.—

“(I) IN GENERAL.—The term ‘trade or business’ means any trade or business, including any line of business, qualifying as an active trade or business within the meaning of section 355.

“(II) RENTAL OF REAL PROPERTY.—For purposes of this clause, the holding of real property for rental shall not be treated as an active trade or business.

“(c) MARKET DISCOUNT RULES.—

“(1) ORDINARY INCOME TREATMENT.—Section 1276 of the Internal Revenue Code of 1986 (as added by section 41) shall apply to obligations issued after the date of the enactment of this Act [July 18, 1984] in taxable years ending after such date.

“(2) INTEREST DEFERRAL RULES.—Section 1277 of such Code (as added by section 41) shall apply to obligations acquired after the date of the enactment of this Act in taxable years ending after such date.

“(d) RULES RELATING TO DISCOUNT ON SHORT-TERM OBLIGATIONS.—Subpart C of part V of subchapter P of

chapter 1 of such Code (as added by section 41) shall apply to obligations acquired after the date of the enactment of this Act [July 18, 1984].

“(e) 5-YEAR SPREAD OF ADJUSTMENTS REQUIRED BY REASON OF ACCRUAL OF DISCOUNT ON CERTAIN SHORT-TERM OBLIGATIONS.—

“(1) ELECTION TO HAVE SECTION 1281 APPLY TO ALL OBLIGATIONS HELD DURING TAXABLE YEAR.—A taxpayer may elect for his first taxable year ending after the date of the enactment of this Act [July 18, 1984] to have section 1281 of the Internal Revenue Code of 1986 apply to all short-term obligations described in subsection (b) of such section which were held by the taxpayer at any time during such first taxable year.

“(2) 5-YEAR SPREAD.—

“(A) IN GENERAL.—In the case of any taxpayer who makes an election under paragraph (1)—

“(i) the provisions of section 1281 of the Internal Revenue Code of 1986 (as added by section 41) shall be treated as a change in the method of accounting of the taxpayer,

“(ii) such change shall be treated as having been made with the consent of the Secretary, and

“(iii) the net amount of the adjustments required by section 481(a) of such Code to be taken into account by the taxpayer in computing taxable income (hereinafter in this paragraph referred to as the ‘net adjustments’) shall be taken into account during the spread period with the amount taken into account in each taxable year in such period determined under subparagraph (B).

“(B) AMOUNT TAKEN INTO ACCOUNT DURING EACH YEAR OF SPREAD PERIOD.—

“(i) FIRST YEAR.—The amount taken into account for the first taxable year in the spread period shall be the sum of—

“(I) one-fifth of the net adjustments, and

“(II) the excess (if any) of—

“(a) the cash basis income over the accrual basis income, over

“(b) one-fifth of the net adjustments.

“(ii) FOR SUBSEQUENT YEARS IN SPREAD PERIOD.—The amount taken into account in the second or any succeeding taxable year in the spread period shall be the sum of—

“(I) the portion of the net adjustments not taken into account in the preceding taxable year of the spread period divided by the number of remaining taxable years in the spread period (including the year for which the determination is being made), and

“(II) the excess (if any) of—

“(a) the excess of the cash basis income over the accrual basis income, over

“(b) one-fifth of the net adjustments, multiplied by 5 minus the number of years remaining in the spread period (not including the current year).

The excess described in subparagraph (B)(ii)(II)(a) shall be reduced by any amount taken into account under this subclause or clause (i)(II) in any prior year.

“(C) SPREAD PERIOD.—For purposes of this paragraph, the term ‘spread period’ means the period consisting of the 5 taxable years beginning with the year for which the election is made under paragraph (1).

“(D) CASH BASIS INCOME.—For purposes of this paragraph, the term ‘cash basis income’ means for any taxable year the aggregate amount which would be includible in the gross income of the taxpayer with respect to short-term obligations described in subsection (b) of section 1281 of such Code if the provisions of section 1281 of such Code did not apply to such taxable year and all prior taxable years within the spread period.

“(E) ACCRUAL BASIS INCOME.—For purposes of this paragraph, the term ‘accrual basis income’ means for any taxable year the aggregate amount includ-

ible in gross income under section 1281(a) of such Code for such a taxable year and all prior taxable years within the spread period.

“(f) TREATMENT OF ORIGINAL ISSUE DISCOUNT ON TAX-EXEMPT OBLIGATIONS.—Section 1288 of such Code (as added by section 41) shall apply to obligations issued after September 3, 1982, and acquired after March 1, 1984.

“(g) REPEAL OF CAPITAL ASSET REQUIREMENT.—Section 1272 of such Code (as added by section 41) shall not apply to any obligation issued on or before December 31, 1984, which is not a capital asset in the hands of the taxpayer.

“(h) REPORTING REQUIREMENTS.—Section 1275(c) of such Code (as added by section 41) and the amendments made by section 41(c) [enacting section 6706 of this title] shall take effect on the day 30 days after the date of the enactment of this Act [July 18, 1984].

“(i) OTHER MISCELLANEOUS CHANGES.—

“(1) ACCRUAL PERIOD.—In the case of any obligation issued after July 1, 1982, and before January 1, 1985, the accrual period, for purposes of section 1272(a) of the Internal Revenue Code of 1986 (as amended by section 41(a)), shall be a 1-year period (or shorter period to maturity) beginning on the day in the calendar year which corresponds to the date of original issue of the obligation.

“(2) CHANGE IN REDUCTION FOR PURCHASE AFTER ORIGINAL ISSUE.—Section 1272(a)(6) of such Code (as so amended) shall not apply to any purchase on or before the date of the enactment of this Act [July 18, 1984], and the rules of section 1232A(a)(6) of such Code (as in effect on the day before the date of the enactment of this Act) shall continue to apply to such purchase.

“(j) CLARIFICATION THAT PRIOR EFFECTIVE DATE RULES NOT AFFECTED.—Nothing in the amendment made by section 41(a) shall affect the application of any effective date provision (including any transitional rule) for any provision which was a predecessor to any provision contained in part V of subchapter P of chapter 1 of the Internal Revenue Code of 1954 (as added by section 41).”

[Amendment of section 44 of Pub. L. 98-369, set out above, by Pub. L. 98-612 (which added pars. (4) to (7) to subsec. (b)) not applicable to sales and exchanges after June 30, 1985, in taxable years ending after such date, see section 105(a)(1) of Pub. L. 99-121, set out as an Effective Date of 1985 Amendment note under section 1274 of this title.]

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1272. Current inclusion in income of original issue discount

(a) Original issue discount on debt instruments issued after July 1, 1982, included in income on basis of constant interest rate

(1) General rule

For purposes of this title, there shall be included in the gross income of the holder of any debt instrument having original issue discount issued after July 1, 1982, an amount equal to the sum of the daily portions of the original issue discount for each day during the taxable year on which such holder held such debt instrument.

(2) Exceptions

Paragraph (1) shall not apply to—

(A) Tax-exempt obligations

Any tax-exempt obligation.

(B) United States savings bonds

Any United States savings bond.

(C) Short-term obligations

Any debt instrument which has a fixed maturity date not more than 1 year from the date of issue.

(D) Obligations issued by natural persons before March 2, 1984

Any obligation issued by a natural person before March 2, 1984.

(E) Loans between natural persons**(i) In general**

Any loan made by a natural person to another natural person if—

(I) such loan is not made in the course of a trade or business of the lender, and

(II) the amount of such loan (when increased by the outstanding amount of prior loans by such natural person to such other natural person) does not exceed \$10,000.

(ii) Clause (i) not to apply where tax avoidance a principal purpose

Clause (i) shall not apply if the loan has as 1 of its principal purposes the avoidance of any Federal tax.

(iii) Treatment of husband and wife

For purposes of this subparagraph, a husband and wife shall be treated as 1 person. The preceding sentence shall not apply where the spouses lived apart at all times during the taxable year in which the loan is made.

(3) Determination of daily portions

For purposes of paragraph (1), the daily portion of the original issue discount on any debt instrument shall be determined by allocating to each day in any accrual period its ratable portion of the increase during such accrual period in the adjusted issue price of the debt instrument. For purposes of the preceding sentence, the increase in the adjusted issue price for any accrual period shall be an amount equal to the excess (if any) of—

(A) the product of—

(i) the adjusted issue price of the debt instrument at the beginning of such accrual period, and

(ii) the yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period), over

(B) the sum of the amounts payable as interest on such debt instrument during such accrual period.

(4) Adjusted issue price

For purposes of this subsection, the adjusted issue price of any debt instrument at the beginning of any accrual period is the sum of—

(A) the issue price of such debt instrument, plus

(B) the adjustments under this subsection to such issue price for all periods before the first day of such accrual period.

(5) Accrual period

Except as otherwise provided in regulations prescribed by the Secretary, the term “accrual period” means a 6-month period (or shorter period from the date of original issue of the debt instrument) which ends on a day in the calendar year corresponding to the maturity date of the debt instrument or the date 6 months before such maturity date.

(6) Determination of daily portions where principal subject to acceleration**(A) In general**

In the case of any debt instrument to which this paragraph applies, the daily portion of the original issue discount shall be determined by allocating to each day in any accrual period its ratable portion of the excess (if any) of—

(i) the sum of (I) the present value determined under subparagraph (B) of all remaining payments under the debt instrument as of the close of such period, and (II) the payments during the accrual period of amounts included in the stated redemption price of the debt instrument, over

(ii) the adjusted issue price of such debt instrument at the beginning of such period.

(B) Determination of present value

For purposes of subparagraph (A), the present value shall be determined on the basis of—

(i) the original yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period),

(ii) events which have occurred before the close of the accrual period, and

(iii) a prepayment assumption determined in the manner prescribed by regulations.

(C) Debt instruments to which paragraph applies

This paragraph applies to—

(i) any regular interest in a REMIC or qualified mortgage held by a REMIC,

(ii) any other debt instrument if payments under such debt instrument may be accelerated by reason of prepayments of other obligations securing such debt instrument (or, to the extent provided in regulations, by reason of other events), or

(iii) any pool of debt instruments the yield on which may be affected by reason of prepayments (or to the extent provided in regulations, by reason of other events).

To the extent provided in regulations prescribed by the Secretary, in the case of a small business engaged in the trade or business of selling tangible personal property at retail, clause (iii) shall not apply to debt instruments incurred in the ordinary course of such trade or business while held by such business.

(7) Reduction where subsequent holder pays acquisition premium

(A) Reduction

For purposes of this subsection, in the case of any purchase after its original issue of a debt instrument to which this subsection applies, the daily portion for any day shall be reduced by an amount equal to the amount which would be the daily portion for such day (without regard to this paragraph) multiplied by the fraction determined under subparagraph (B).

(B) Determination of fraction

For purposes of subparagraph (A), the fraction determined under this subparagraph is a fraction—

(i) the numerator of which is the excess (if any) of—

(I) the cost of such debt instrument incurred by the purchaser, over

(II) the issue price of such debt instrument, increased by the portion of original issue discount previously includible in the gross income of any holder (computed without regard to this paragraph), and

(ii) the denominator of which is the sum of the daily portions for such debt instrument for all days after the date of such purchase and ending on the stated maturity date (computed without regard to this paragraph).

(b) Ratable inclusion retained for corporate debt instruments issued before July 2, 1982

(1) General rule

There shall be included in the gross income of the holder of any debt instrument issued by a corporation after May 27, 1969, and before July 2, 1982—

(A) the ratable monthly portion of original issue discount, multiplied by

(B) the number of complete months (plus any fractional part of a month determined under paragraph (3)) such holder held such debt instrument during the taxable year.

(2) Determination of ratable monthly portion

Except as provided in paragraph (4), the ratable monthly portion of original issue discount shall equal—

(A) the original issue discount, divided by

(B) the number of complete months from the date of original issue to the stated maturity date of the debt instrument.

(3) Month defined

For purposes of this subsection—

(A) Complete month

A complete month commences with the date of original issue and the corresponding day of each succeeding calendar month (or the last day of a calendar month in which there is no corresponding day).

(B) Transfers during month

In any case where a debt instrument is acquired on any day other than a day determined under subparagraph (A), the ratable monthly portion of original issue discount

for the complete month (or partial month) in which such acquisition occurs shall be allocated between the transferor and the transferee in accordance with the number of days in such complete (or partial) month each held the debt instrument.

(4) Reduction where subsequent holder pays acquisition premium

(A) Reduction

For purposes of this subsection, the ratable monthly portion of original issue discount shall not include its share of the acquisition premium.

(B) Share of acquisition premium

For purposes of subparagraph (A), any month's share of the acquisition premium is an amount (determined at the time of the purchase) equal to—

(i) the excess of—

(I) the cost of such debt instrument incurred by the holder, over

(II) the issue price of such debt instrument, increased by the portion of original issue discount previously includible in the gross income of any holder (computed without regard to this paragraph),

(ii) divided by the number of complete months (plus any fractional part of a month) from the date of such purchase to the stated maturity date of such debt instrument.

(c) Exceptions

This section shall not apply to any holder—

(1) who has purchased the debt instrument at a premium, or

(2) which is a life insurance company to which section 811(b) applies.

(d) Definition and special rule

(1) Purchase defined

For purposes of this section, the term “purchase” means—

(A) any acquisition of a debt instrument, where

(B) the basis of the debt instrument is not determined in whole or in part by reference to the adjusted basis of such debt instrument in the hands of the person from whom acquired.

(2) Basis adjustment

The basis of any debt instrument in the hands of the holder thereof shall be increased by the amount included in his gross income pursuant to this section.

(Added Pub. L. 98-369, div. A, title I, § 41(a), July 18, 1984, 98 Stat. 533; amended Pub. L. 99-514, title VI, § 672, Oct. 22, 1986, 100 Stat. 2318; Pub. L. 105-34, title X, § 1004(a), Aug. 5, 1997, 111 Stat. 911.)

AMENDMENTS

1997—Subsec. (a)(6)(C). Pub. L. 105-34 added cl. (iii) and concluding provisions.

1986—Subsec. (a)(6), (7). Pub. L. 99-514 added par. (6) and redesignated former par. (6) as (7).

EFFECTIVE DATE OF 1997 AMENDMENT

Section 1004(b)(1) of Pub. L. 105-34 provided that: “The amendment made by this section [amending this

section] shall apply to taxable years beginning after the date of the enactment of this Act [Aug. 5, 1997].”

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 applicable to debt instruments issued after Dec. 31, 1986, in taxable years ending after such date, see section 675(b) of Pub. L. 99-514, set out as an Effective Date note under section 860A of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, but not applicable to any obligation issued on or before Dec. 31, 1984, which is not a capital asset in the hands of the taxpayer, and subsec. (a)(6) of this section not applicable to any purchase on or before July 18, 1984, see section 44 of Pub. L. 98-369, as amended, set out as a note under section 1271 of this title.

CHANGE IN METHOD OF ACCOUNTING

Section 1004(b)(2) of Pub. L. 105-34 provided that: “In the case of any taxpayer required by this section [amending this section and enacting provisions set out as a note above] to change its method of accounting for its first taxable year beginning after the date of the enactment of this Act [Aug. 5, 1997]—

“(A) such change shall be treated as initiated by the taxpayer,

“(B) such change shall be treated as made with the consent of the Secretary of the Treasury, and

“(C) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of the Internal Revenue Code of 1986 shall be taken into account ratably over the 4-taxable year period beginning with such first taxable year.”

§ 1273. Determination of amount of original issue discount

(a) General rule

For purposes of this subpart—

(1) In general

The term “original issue discount” means the excess (if any) of—

(A) the stated redemption price at maturity, over

(B) the issue price.

(2) Stated redemption price at maturity

The term “stated redemption price at maturity” means the amount fixed by the last modification of the purchase agreement and includes interest and other amounts payable at that time (other than any interest based on a fixed rate, and payable unconditionally at fixed periodic intervals of 1 year or less during the entire term of the debt instrument).

(3) $\frac{1}{4}$ of 1 percent de minimis rule

If the original issue discount determined under paragraph (1) is less than—

(A) $\frac{1}{4}$ of 1 percent of the stated redemption price at maturity, multiplied by

(B) the number of complete years to maturity,

then the original issue discount shall be treated as zero.

(b) Issue price

For purposes of this subpart—

(1) Publicly offered debt instruments not issued for property

In the case of any issue of debt instruments—

- (A) publicly offered, and
- (B) not issued for property,

the issue price is the initial offering price to the public (excluding bond houses and brokers) at which price a substantial amount of such debt instruments was sold.

(2) Other debt instruments not issued for property

In the case of any issue of debt instruments not issued for property and not publicly offered, the issue price of each such instrument is the price paid by the first buyer of such debt instrument.

(3) Debt instruments issued for property where there is public trading

In the case of a debt instrument which is issued for property and which—

(A) is part of an issue a portion of which is traded on an established securities market, or

(B)(i) is issued for stock or securities which are traded on an established securities market, or

(ii) to the extent provided in regulations, is issued for property (other than stock or securities) of a kind regularly traded on an established market,

the issue price of such debt instrument shall be the fair market value of such property.

(4) Other cases

Except in any case—

(A) to which paragraph (1), (2), or (3) of this subsection applies, or

(B) to which section 1274 applies,

the issue price of a debt instrument which is issued for property shall be the stated redemption price at maturity.

(5) Property

In applying this subsection, the term “property” includes services and the right to use property, but such term does not include money.

(c) Special rules for applying subsection (b)

For purposes of subsection (b)—

(1) Initial offering price; price paid by the first buyer

The terms “initial offering price” and “price paid by the first buyer” include the aggregate payments made by the purchaser under the purchase agreement, including modifications thereof.

(2) Treatment of investment units

In the case of any debt instrument and an option, security, or other property issued together as an investment unit—

(A) the issue price for such unit shall be determined in accordance with the rules of this subsection and subsection (b) as if it were a debt instrument,

(B) the issue price determined for such unit shall be allocated to each element of such unit on the basis of the relationship of the fair market value of such element to the fair market value of all elements in such unit, and

(C) the issue price of any debt instrument included in such unit shall be the portion of the issue price of the unit allocated to the debt instrument under subparagraph (B).

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 536; amended Pub. L. 99-514, title XVIII, §1803(a)(10), Oct. 22, 1986, 100 Stat. 2794.)

AMENDMENTS

1986—Subsec. (b)(3)(B). Pub. L. 99-514 amended subpar. (B) generally, designating existing provisions as cl. (i) and adding cl. (ii).

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, except as otherwise provided, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1274. Determination of issue price in the case of certain debt instruments issued for property

(a) In general

In the case of any debt instrument to which this section applies, for purposes of this subpart, the issue price shall be—

- (1) where there is adequate stated interest, the stated principal amount, or
- (2) in any other case, the imputed principal amount.

(b) Imputed principal amount

For purposes of this section—

(1) In general

Except as provided in paragraph (3), the imputed principal amount of any debt instrument shall be equal to the sum of the present values of all payments due under such debt instrument.

(2) Determination of present value

For purposes of paragraph (1), the present value of a payment shall be determined in the manner provided by regulations prescribed by the Secretary—

- (A) as of the date of the sale or exchange, and
- (B) by using a discount rate equal to the applicable Federal rate, compounded semi-annually.

(3) Fair market value rule in potentially abusive situations

(A) In general

In the case of any potentially abusive situation, the imputed principal amount of any

debt instrument received in exchange for property shall be the fair market value of such property adjusted to take into account other consideration involved in the transaction.

(B) Potentially abusive situation defined

For purposes of subparagraph (A), the term “potentially abusive situation” means—

- (i) a tax shelter (as defined in section 6662(d)(2)(C)(iii)),¹ and
- (ii) any other situation which, by reason of—
 - (I) recent sales transactions,
 - (II) nonrecourse financing,
 - (III) financing with a term in excess of the economic life of the property, or
 - (IV) other circumstances,

is of a type which the Secretary specifies by regulations as having potential for tax avoidance.

(c) Debt instruments to which section applies

(1) In general

Except as otherwise provided in this subsection, this section shall apply to any debt instrument given in consideration for the sale or exchange of property if—

(A) the stated redemption price at maturity for such debt instrument exceeds—

- (i) where there is adequate stated interest, the stated principal amount, or
- (ii) in any other case, the imputed principal amount of such debt instrument determined under subsection (b), and

(B) some or all of the payments due under such debt instrument are due more than 6 months after the date of such sale or exchange.

(2) Adequate stated interest

For purposes of this section, there is adequate stated interest with respect to any debt instrument if the stated principal amount for such debt instrument is less than or equal to the imputed principal amount of such debt instrument determined under subsection (b).

(3) Exceptions

This section shall not apply to—

(A) Sales for \$1,000,000 or less of farms by individuals or small businesses

(i) In general

Any debt instrument arising from the sale or exchange of a farm (within the meaning of section 6420(c)(2))—

- (I) by an individual, estate, or testamentary trust,
- (II) by a corporation which as of the date of the sale or exchange is a small business corporation (as defined in section 1244(c)(3)), or
- (III) by a partnership which as of the date of the sale or exchange meets requirements similar to those of section 1244(c)(3).

(ii) \$1,000,000 limitation

Clause (i) shall apply only if it can be determined at the time of the sale or ex-

¹ See References in Text note below.

change that the sales price cannot exceed \$1,000,000. For purposes of the preceding sentence, all sales and exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange.

(B) Sales of principal residences

Any debt instrument arising from the sale or exchange by an individual of his principal residence (within the meaning of section 121).

(C) Sales involving total payments of \$250,000 or less

(i) In general

Any debt instrument arising from the sale or exchange of property if the sum of the following amounts does not exceed \$250,000:

(I) the aggregate amount of the payments due under such debt instrument and all other debt instruments received as consideration for the sale or exchange, and

(II) the aggregate amount of any other consideration to be received for the sale or exchange.

(ii) Consideration other than debt instrument taken into account at fair market value

For purposes of clause (i), any consideration (other than a debt instrument) shall be taken into account at its fair market value.

(iii) Aggregation of transactions

For purposes of this subparagraph, all sales and exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange.

(D) Debt instruments which are publicly traded or issued for publicly traded property

Any debt instrument to which section 1273(b)(3) applies.

(E) Certain sales of patents

In the case of any transfer described in section 1235(a) (relating to sale or exchange of patents), any amount contingent on the productivity, use, or disposition of the property transferred.

(F) Sales or exchanges to which section 483(e) applies

Any debt instrument to the extent section 483(e) (relating to certain land transfers between related persons) applies to such instrument.

(4) Exception for assumptions

If any person—

(A) in connection with the sale or exchange of property, assumes any debt instrument, or

(B) acquires any property subject to any debt instrument,

in determining whether this section or section 483 applies to such debt instrument, such as-

sumption (or such acquisition) shall not be taken into account unless the terms and conditions of such debt instrument are modified (or the nature of the transaction is changed) in connection with the assumption (or acquisition).

(d) Determination of applicable Federal rate

For purposes of this section—

(1) Applicable Federal rate

(A) In general

In the case of a debt instrument with a term of:	The applicable Federal rate is:
Not over 3 years	The Federal short-term rate.
Over 3 years but not over 9 years	The Federal mid-term rate.
Over 9 years	The Federal long-term rate.

(B) Determination of rates

During each calendar month, the Secretary shall determine the Federal short-term rate, mid-term rate, and long-term rate which shall apply during the following calendar month.

(C) Federal rate for any calendar month

For purposes of this paragraph—

(i) Federal short-term rate

The Federal short-term rate shall be the rate determined by the Secretary based on the average market yield (during any 1-month period selected by the Secretary and ending in the calendar month in which the determination is made) on outstanding marketable obligations of the United States with remaining periods to maturity of 3 years or less.

(ii) Federal mid-term and long-term rates

The Federal mid-term and long-term rate shall be determined in accordance with the principles of clause (i).

(D) Lower rate permitted in certain cases

The Secretary may by regulations permit a rate to be used with respect to any debt instrument which is lower than the applicable Federal rate if the taxpayer establishes to the satisfaction of the Secretary that such lower rate is based on the same principles as the applicable Federal rate and is appropriate for the term of such instrument.

(2) Lowest 3-month rate applicable to any sale or exchange

(A) In general

In the case of any sale or exchange, the applicable Federal rate shall be the lowest 3-month rate.

(B) Lowest 3-month rate

For purposes of subparagraph (A), the term “lowest 3-month rate” means the lowest of the applicable Federal rates in effect for any month in the 3-calendar-month period ending with the 1st calendar month in which there is a binding contract in writing for such sale or exchange.

(3) Term of debt instrument

In determining the term of a debt instrument for purposes of this subsection, under

regulations prescribed by the Secretary, there shall be taken into account options to renew or extend.

(e) 110 Percent rate where sale-leaseback involved

(1) In general

In the case of any debt instrument to which this subsection applies, the discount rate used under subsection (b)(2)(B) or section 483(b) shall be 110 percent of the applicable Federal rate, compounded semiannually.

(2) Lower discount rates shall not apply

Section 1274A shall not apply to any debt instrument to which this subsection applies.

(3) Debt instruments to which this subsection applies

This subsection shall apply to any debt instrument given in consideration for the sale or exchange of any property if, pursuant to a plan, the transferor or any related person leases a portion of such property after such sale or exchange.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 538; amended Pub. L. 99-121, title I, §§101(a)(1), (b), (c), 102(b), Oct. 11, 1985, 99 Stat. 505, 506, 508; Pub. L. 99-514, title XVIII, §1803(a)(14)(A), Oct. 22, 1986, 100 Stat. 2797; Pub. L. 101-239, title VII, §7721(c)(11), Dec. 19, 1989, 103 Stat. 2400; Pub. L. 104-188, title I, §1704(t)(78), Aug. 20, 1996, 110 Stat. 1891; Pub. L. 105-34, title III, §312(d)(1), Aug. 5, 1997, 111 Stat. 839.)

REFERENCES IN TEXT

Section 6662(d)(2)(C), referred to in subsec. (b)(3)(B)(i), was subsequently amended and cl. (iii) no longer defines the term “tax shelter”. However, such term is defined elsewhere in that section.

AMENDMENTS

1997—Subsec. (c)(3)(B). Pub. L. 105-34 substituted “section 121” for “section 1034”.

1996—Subsec. (b)(3)(B)(i). Pub. L. 104-188 substituted “section 6662(d)(2)(C)(iii)” for “section 6662(d)(2)(C)(ii)”.

1989—Subsec. (b)(3)(B)(i). Pub. L. 101-239 substituted “section 6662(d)(2)(C)(ii)” for “section 6661(b)(2)(C)(ii)”.

1986—Subsec. (c)(3)(A). Pub. L. 99-514 substituted “for \$1,000,000 or less” for “for less than \$1,000,000” in heading of subsec. (c)(4)(A) as so designated prior to its redesignation as subsec. (c)(3)(A) by Pub. L. 99-121, §101(a)(1)(D), see 1985 Amendment note below.

1985—Subsec. (b)(2)(B). Pub. L. 99-121, §101(a)(1)(A), struck out “120 percent of” after “rate equal to”.

Subsec. (c)(1)(A)(ii). Pub. L. 99-121, §101(a)(1)(B), amended cl. (ii) generally, substituting “the imputed principal amount of such debt instrument determined under subsection (b)” for “the testing amount”.

Subsec. (c)(2). Pub. L. 99-121, §101(a)(1)(C), substituted “the imputed principal amount of such debt instrument determined under subsection (b)” for “the testing amount”.

Subsec. (c)(3). Pub. L. 99-121, §101(a)(1)(D), redesignated par. (4) as (3). Former par. (3), defining “testing amount”, was struck out.

Subsec. (c)(4). Pub. L. 99-121, §102(b), added par. (4). Former par. (4) redesignated (3).

Subsec. (d)(1)(B) to (D). Pub. L. 99-121, §101(b)(1), amended subpars. (B) to (D) generally, in subpar. (B) substituting provisions setting a monthly schedule for the determination of Federal rates for provisions which had formerly set a semi-annual schedule for the determination of such rates, in subpar. (C) substituting provisions setting a monthly schedule for the determina-

tion of Federal short-term, mid-term, and long-term rates based on the average market yield during any 1-month period ending in the month in which the determination is made for former provisions which had directed that the Federal rate determined under subpar. (A) apply during the appropriate 6-month period, and in subpar. (D) substituting provisions allowing a lower rate in certain cases for provisions relating to the setting of the Federal rate for any 6-month period.

Subsec. (d)(2). Pub. L. 99-121, §101(b)(2), amended par. (2) generally. Prior to amendment, par. (2) read as follows: “In the case of any sale or exchange, the determination of the applicable Federal rate shall be made as of the first day on which there is a binding contract in writing for the sale or exchange.”

Subsec. (e). Pub. L. 99-121, §101(c), added subsec. (e).

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 applicable to sales and exchanges after May 6, 1997, with certain exceptions, see section 312(d) of Pub. L. 105-34, set out as a note under section 121 of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101-239 applicable to returns the due date for which (determined without regard to extensions) is after Dec. 31, 1989, see section 7721(d) of Pub. L. 101-239, set out as a note under section 461 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1985 AMENDMENT

Section 105(a) of Pub. L. 99-121, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by sections 101 and 102 [enacting section 1274A and amending this section and sections 280G and 483 of this title] shall apply to sales and exchanges after June 30, 1985, in taxable years ending after such date. The amendment made by section 2 of Public Law 98-612 [amending section 44(b) of Pub. L. 98-369, set out as a note under section 1271 of this title] shall not apply to sales and exchanges after June 30, 1985, in taxable years ending after such date.

“(2) REGULATORY AUTHORITY TO ESTABLISH LOWER RATE.—Section 1274(d)(1)(D) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954], as added by section 101(b), shall apply as if included in the amendments made by section 41 of the Tax Reform Act of 1984 [Pub. L. 98-369, see Effective Date note set out under section 1271 of this title].”

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to sales or exchanges after Dec. 31, 1984, but not applicable to any sale or exchange pursuant to a written contract which was binding on Mar. 1, 1984, and at all times thereafter before the sale or exchange, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

TRANSITIONAL RULE FOR PURPOSES OF IMPUTED
INTEREST RULES

Provisions respecting treatment of debt instruments received in exchange for property, relating to special rules for sales after Dec. 31, 1984, and before July 1, 1985, general rule for assumptions of loans, exception for assumptions of loans made on or before Oct. 15, 1984, and exception for assumptions of loans with respect to certain property, see section 44(b)(4)–(7) of Pub. L. 98–369, as amended, set out as an Effective Date note under section 1271 of this title.

§ 1274A. Special rules for certain transactions where stated principal amount does not exceed \$2,800,000

(a) Lower discount rate

In the case of any qualified debt instrument, the discount rate used for purposes of sections 483 and 1274 shall not exceed 9 percent, compounded semiannually.

(b) Qualified debt instrument defined

For purposes of this section, the term “qualified debt instrument” means any debt instrument given in consideration for the sale or exchange of property (other than new section 38 property within the meaning of section 48(b), as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) if the stated principal amount of such instrument does not exceed \$2,800,000.

(c) Election to use cash method where stated principal amount does not exceed \$2,000,000

(1) In general

In the case of any cash method debt instrument—

(A) section 1274 shall not apply, and

(B) interest on such debt instrument shall be taken into account by both the borrower and the lender under the cash receipts and disbursements method of accounting.

(2) Cash method debt instrument

For purposes of paragraph (1), the term “cash method debt instrument” means any qualified debt instrument if—

(A) the stated principal amount does not exceed \$2,000,000,

(B) the lender does not use an accrual method of accounting and is not a dealer with respect to the property sold or exchanged,

(C) section 1274 would have applied to such instrument but for an election under this subsection, and

(D) an election under this subsection is jointly made with respect to such debt instrument by the borrower and lender.

(3) Successors bound by election

(A) In general

Except as provided in subparagraph (B), paragraph (1) shall apply to any successor to the borrower or lender with respect to a cash method debt instrument.

(B) Exception where lender transfers debt instrument to accrual method taxpayer

If the lender (or any successor) transfers any cash method debt instrument to a taxpayer who uses an accrual method of ac-

counting, this paragraph shall not apply with respect to such instrument for periods after such transfer.

(4) Fair market value rule in potentially abusive situations

In the case of any cash method debt instrument, section 483 shall be applied as if it included provisions similar to the provisions of section 1274(b)(3).

(d) Other special rules

(1) Aggregation rules

For purposes of this section—

(A) all sales or exchanges which are part of the same transaction (or a series of related transactions) shall be treated as 1 sale or exchange, and

(B) all debt instruments arising from the same transaction (or a series of related transactions) shall be treated as 1 debt instrument.

(2) Inflation adjustments

(A) In general

In the case of any debt instrument arising out of a sale or exchange during any calendar year after 1989, each dollar amount contained in the preceding provisions of this section shall be increased by the inflation adjustment for such calendar year. Any increase under the preceding sentence shall be rounded to the nearest multiple of \$100 (or, if such increase is a multiple of \$50, such increase shall be increased to the nearest multiple of \$100).

(B) Inflation adjustment

For purposes of subparagraph (A), the inflation adjustment for any calendar year is the percentage (if any) by which—

(i) the CPI for the preceding calendar year exceeds

(ii) the CPI for calendar year 1988.

For purposes of the preceding sentence, the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on September 30 of such calendar year.

(e) Regulations

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including—

(1) regulations coordinating the provisions of this section with other provisions of this title,

(2) regulations necessary to prevent the avoidance of tax through the abuse of the provisions of subsection (c), and

(3) regulations relating to the treatment of transfers of cash method debt instruments.

(Added Pub. L. 99–121, title I, §102(a), Oct. 11, 1985, 99 Stat. 506; amended Pub. L. 101–508, title XI, §11813(b)(22), Nov. 5, 1990, 104 Stat. 1388–555; Pub. L. 104–188, title I, §1704(t)(62), Aug. 20, 1996, 110 Stat. 1890.)

INFLATION ADJUSTED ITEMS FOR CERTAIN YEARS

For inflation adjustment of certain items in this section, see Revenue Rulings listed in a table below.

REFERENCES IN TEXT

The date of the enactment of the Revenue Reconciliation Act of 1990, referred to in subsec. (b), is the date of enactment of Pub. L. 101-508, which was approved Nov. 5, 1990.

AMENDMENTS

1996—Subsec. (c)(1)(B). Pub. L. 104-188 substituted “instrument” for “instrument”.

1990—Subsec. (b). Pub. L. 101-508 inserted “, as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990” after “section 48(b)”.

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by Pub. L. 101-508 applicable to property placed in service after Dec. 31, 1990, but not applicable to any transition property (as defined in section 49(e) of this title), any property with respect to which qualified progress expenditures were previously taken into account under section 46(d) of this title, and any property described in section 46(b)(2)(C) of this title, as such sections were in effect on Nov. 4, 1990, see section 11813(c) of Pub. L. 101-508, set out as a note under section 45K of this title.

EFFECTIVE DATE

Section applicable to sales and exchanges after June 30, 1985, in taxable years ending after such date, see section 105(a)(1) of Pub. L. 99-121, set out as an Effective Date of 1985 Amendment note under section 1274 of this title.

SAVINGS PROVISION

For provisions that nothing in amendment by Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

INFLATION ADJUSTED ITEMS FOR CERTAIN YEARS

Provisions relating to inflation adjustment of items in this section for certain years were contained in the following:

2012—Revenue Ruling 2011-27.
 2011—Revenue Ruling 2010-30.
 2010—Revenue Ruling 2010-2.
 2009—Revenue Ruling 2008-52.
 2008—Revenue Ruling 2008-3.
 2007—Revenue Ruling 2007-4.
 2006—Revenue Ruling 2005-76.
 2005—Revenue Ruling 2004-107.
 2004—Revenue Ruling 2003-119.
 2003—Revenue Ruling 2002-79.
 2002—Revenue Ruling 2001-65.
 2001—Revenue Ruling 2000-55.
 2000—Revenue Ruling 99-50.
 1999—Revenue Ruling 98-58.
 1998—Revenue Ruling 97-56.
 1997—Revenue Ruling 96-63.
 1996—Revenue Ruling 96-4.

§ 1275. Other definitions and special rules

(a) Definitions

For purposes of this subpart—

(1) Debt instrument

(A) In general

Except as provided in subparagraph (B), the term “debt instrument” means a bond, debenture, note, or certificate or other evidence of indebtedness.

(B) Exception for certain annuity contracts

The term “debt instrument” shall not include any annuity contract to which section 72 applies and which—

(i) depends (in whole or in substantial part) on the life expectancy of 1 or more individuals, or

(ii) is issued by an insurance company subject to tax under subchapter L (or by an entity described in section 501(c) and exempt from tax under section 501(a) which would be subject to tax under subchapter L were it not so exempt)—

(I) in a transaction in which there is no consideration other than cash or another annuity contract meeting the requirements of this clause,

(II) pursuant to the exercise of an election under an insurance contract by a beneficiary thereof on the death of the insured party under such contract, or

(III) in a transaction involving a qualified pension or employee benefit plan.

(2) Issue date

(A) Publicly offered debt instruments

In the case of any debt instrument which is publicly offered, the term “date of original issue” means the date on which the issue was first issued to the public.

(B) Issues not publicly offered and not issued for property

In the case of any debt instrument to which section 1273(b)(2) applies, the term “date of original issue” means the date on which the debt instrument was sold by the issuer.

(C) Other debt instruments

In the case of any debt instrument not described in subparagraph (A) or (B), the term “date of original issue” means the date on which the debt instrument was issued in a sale or exchange.

(3) Tax-exempt obligation

The term “tax-exempt obligation” means any obligation if—

(A) the interest on such obligation is not includible in gross income under section 103, or

(B) the interest on such obligation is exempt from tax (without regard to the identity of the holder) under any other provision of law.

(4) Treatment of obligations distributed by corporations

Any debt obligation of a corporation distributed by such corporation with respect to its stock shall be treated as if it had been issued by such corporation for property.

(b) Treatment of borrower in the case of certain loans for personal use

(1) Sections 1274 and 483 not to apply

In the case of the obligor under any debt instrument given in consideration for the sale or exchange of property, sections 1274 and 483 shall not apply if such property is personal use property.

(2) Original issue discount deducted on cash basis in certain cases

In the case of any debt instrument, if—

(A) such instrument—

(i) is incurred in connection with the acquisition or carrying of personal use property, and

(ii) has original issue discount (determined after the application of paragraph (1)), and

(B) the obligor under such instrument uses the cash receipts and disbursements method of accounting,

notwithstanding section 163(e), the original issue discount on such instrument shall be deductible only when paid.

(3) Personal use property

For purposes of this subsection, the term “personal use property” means any property substantially all of the use of which by the taxpayer is not in connection with a trade or business of the taxpayer or an activity described in section 212. The determination of whether property is described in the preceding sentence shall be made as of the time of issuance of the debt instrument.

(c) Information requirements

(1) Information required to be set forth on instrument

(A) In general

In the case of any debt instrument having original issue discount, the Secretary may by regulations require that—

- (i) the amount of the original issue discount, and
- (ii) the issue date,

be set forth on such instrument.

(B) Special rule for instruments not publicly offered

In the case of any issue of debt instruments not publicly offered, the regulations prescribed under subparagraph (A) shall not require the information to be set forth on the debt instrument before any disposition of such instrument by the first buyer.

(2) Information required to be submitted to Secretary

In the case of any issue of publicly offered debt instruments having original issue discount, the issuer shall (at such time and in such manner as the Secretary shall by regulation prescribe) furnish the Secretary the following information:

- (A) The amount of the original issue discount.
- (B) The issue date.
- (C) Such other information with respect to the issue as the Secretary may by regulations require.

For purposes of the preceding sentence, any person who makes a public offering of stripped bonds (or stripped coupons) shall be treated as the issuer of a publicly offered debt instrument having original issue discount.

(3) Exceptions

This subsection shall not apply to any obligation referred to in section 1272(a)(2) (relating to exceptions from current inclusion of original issue discount).

(4) Cross reference

For civil penalty for failure to meet requirements of this subsection, see section 6706.

(d) Regulation authority

The Secretary may prescribe regulations providing that where, by reason of varying rates of interest, put or call options, indefinite maturities, contingent payments, assumptions of debt instruments, or other circumstances, the tax treatment under this subpart (or section 163(e)) does not carry out the purposes of this subpart (or section 163(e)), such treatment shall be modified to the extent appropriate to carry out the purposes of this subpart (or section 163(e)).

(Added and amended Pub. L. 98-369, div. A, title I, §§41(a), 61(c)(2), July 18, 1984, 98 Stat. 540, 581; Pub. L. 99-514, title XVIII, §1804(f)(2)(A), Oct. 22, 1986, 100 Stat. 2805; Pub. L. 100-647, title I, §1006(u)(4), Nov. 10, 1988, 102 Stat. 3427; Pub. L. 101-508, title XI, §11325(a)(2), Nov. 5, 1990, 104 Stat. 1388-466; Pub. L. 106-554, §1(a)(7) [title III, §318(c)(1)], Dec. 21, 2000, 114 Stat. 2763, 2763A-645.)

AMENDMENTS

2000—Subsec. (a)(1)(B)(ii). Pub. L. 106-554, in introductory provisions, substituted “subchapter L (or by an entity described in section 501(c) and exempt from tax under section 501(a) which would be subject to tax under subchapter L were it not so exempt)” for “subchapter L”.

1990—Subsec. (a)(4), (5). Pub. L. 101-508 redesignated par. (5) as (4) and struck out former par. (4) which related to a special rule for determination of issue price in case of exchange of debt instruments in reorganization.

1988—Subsec. (a)(4)(B)(ii)(I). Pub. L. 100-647 substituted “subsection (a)(7)” for “subsection (a)(6)”.

1986—Subsec. (a)(4), (5). Pub. L. 99-514 redesignated par. (4), relating to treatment of obligations distributed to corporations, as (5), and substituted “by corporations” for “to corporations” in heading.

1984—Subsec. (a)(4). Pub. L. 98-369, §61(c)(2), added par. (4) relating to treatment of obligations distributed to corporations.

EFFECTIVE DATE OF 2000 AMENDMENT

Pub. L. 106-554, §1(a)(7) [title III, §318(c)(2)], Dec. 21, 2000, 114 Stat. 2763, 2763A-645, provided that: “The amendment made by this subsection [amending this section] shall take effect as if included in the amendments made by section 41 of the Tax Reform Act of 1984 [Pub. L. 98-369, div. A].”

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by Pub. L. 101-508 applicable, with certain exceptions, to debt instruments issued and stock transferred after Oct. 1, 1990, in satisfaction of any indebtedness, see section 11325(c) of Pub. L. 101-508, set out as a note under section 108 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 applicable with respect to distributions declared Mar. 15, 1984, in taxable years

ending after that date, see section 61(e)(3) of Pub. L. 98-369, set out as a note under section 312 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, but subsec. (c) of this section effective on the day 30 days after July 18, 1984, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

SUBPART B—MARKET DISCOUNT ON BONDS

Sec.

- 1276. Disposition gain representing accrued market discount treated as ordinary income.
- 1277. Deferral of interest deduction allocable to accrued market discount.
- 1278. Definitions and special rules.

§ 1276. Disposition gain representing accrued market discount treated as ordinary income

(a) Ordinary income

(1) In general

Except as otherwise provided in this section, gain on the disposition of any market discount bond shall be treated as ordinary income to the extent it does not exceed the accrued market discount on such bond. Such gain shall be recognized notwithstanding any other provision of this subtitle.

(2) Dispositions other than sales, etc.

For purposes of paragraph (1), a person disposing of any market discount bond in any transaction other than a sale, exchange, or involuntary conversion shall be treated as realizing an amount equal to the fair market value of the bond.

(3) Treatment of partial principal payments

(A) In general

Any partial principal payment on a market discount bond shall be included in gross income as ordinary income to the extent such payment does not exceed the accrued market discount on such bond.

(B) Adjustment

If subparagraph (A) applies to any partial principal payment on any market discount bond, for purposes of applying this section to any disposition of (or subsequent partial principal payment on) such bond, the amount of accrued market discount shall be reduced by the amount of such partial principal payment included in gross income under subparagraph (A).

(4) Gain treated as interest for certain purposes

Except for purposes of sections 103, 871(a),¹ 881, 1441, 1442, and 6049 (and such other provi-

sions as may be specified in regulations), any amount treated as ordinary income under paragraph (1) or (3) shall be treated as interest for purposes of this title.

(b) Accrued market discount

For purposes of this section—

(1) Ratable accrual

Except as otherwise provided in this subsection or subsection (c), the accrued market discount on any bond shall be an amount which bears the same ratio to the market discount on such bond as—

(A) the number of days which the taxpayer held the bond, bears to

(B) the number of days after the date the taxpayer acquired the bond and up to (and including) the date of its maturity.

(2) Election of accrual on basis of constant interest rate (in lieu of ratable accrual)

(A) In general

At the election of the taxpayer with respect to any bond, the accrued market discount on such bond shall be the aggregate amount which would have been includible in the gross income of the taxpayer under section 1272(a) (determined without regard to paragraph (2) thereof) with respect to such bond for all periods during which the bond was held by the taxpayer if such bond had been—

(i) originally issued on the date on which such bond was acquired by the taxpayer,

(ii) for an issue price equal to the basis of the taxpayer in such bond immediately after its acquisition.

(B) Coordination where bond has original issue discount

In the case of any bond having original issue discount, for purposes of applying subparagraph (A)—

(i) the stated redemption price at maturity of such bond shall be treated as equal to its revised issue price, and

(ii) the determination of the portion of the original issue discount which would have been includible in the gross income of the taxpayer under section 1272(a) shall be made under regulations prescribed by the Secretary.

(C) Election irrevocable

An election under subparagraph (A), once made with respect to any bond, shall be irrevocable.

(3) Special rule where partial principal payments

In the case of a bond the principal of which may be paid in 2 or more payments, the amount of accrued market discount shall be determined under regulations prescribed by the Secretary.

(c) Treatment of nonrecognition transactions

Under regulations prescribed by the Secretary—

(1) Transferred basis property

If a market discount bond is transferred in a nonrecognition transaction and such bond is

¹ So in original.

transferred basis property in the hands of the transferee, for purposes of determining the amount of the accrued market discount with respect to the transferee—

(A) the transferee shall be treated as having acquired the bond on the date on which it was acquired by the transferor for an amount equal to the basis of the transferor, and

(B) proper adjustments shall be made for gain recognized by the transferor on such transfer (and for any original issue discount or market discount included in the gross income of the transferor).

(2) Exchanged basis property

If any market discount bond is disposed of by the taxpayer in a nonrecognition transaction and paragraph (1) does not apply to such transaction, any accrued market discount determined with respect to the property disposed of to the extent not theretofore treated as ordinary income under subsection (a)—

(A) shall be treated as accrued market discount with respect to the exchanged basis property received by the taxpayer in such transaction if such property is a market discount bond, and

(B) shall be treated as ordinary income on the disposition of the exchanged basis property received by the taxpayer in such exchange if such property is not a market discount bond.

(3) Paragraph (1) to apply to certain distributions by corporations or partnerships

For purposes of paragraph (1), if the basis of any market discount bond in the hands of a transferee is determined under section 732(a), or 732(b), such property shall be treated as transferred basis property in the hands of such transferee.

(d) Special rules

Under regulations prescribed by the Secretary—

(1) rules similar to the rules of subsection (b) of section 1245 shall apply for purposes of this section; except that—

(A) paragraph (1) of such subsection shall not apply,

(B) an exchange qualifying under section 354(a), 355(a), or 356(a) (determined without regard to subsection (a) of this section) shall be treated as an exchange described in paragraph (3) of such subsection, and

(C) paragraph (3) of section 1245(b) shall be applied as if it did not contain a reference to section 351, and

(2) appropriate adjustments shall be made to the basis of any property to reflect gain recognized under subsection (a).

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 543; amended Pub. L. 99-514, title VI, §631(e)(15), title XVIII, §§1803(a)(5), (13)(A), 1899A(28), Oct. 22, 1986, 100 Stat. 2275, 2793, 2796, 2960; Pub. L. 100-647, title I, §1018(u)(46), Nov. 10, 1988, 102 Stat. 3592; Pub. L. 103-66, title XIII, §13206(b)(1)(A), (2)(B)(i), Aug. 10, 1993, 107 Stat. 465.)

AMENDMENTS

1993—Subsec. (a)(4). Pub. L. 103-66, §13206(b)(2)(B)(i), substituted “sections 103, 871(a),” for “sections 871(a)”.

Subsec. (e). Pub. L. 103-66, §13206(b)(1)(A), struck out heading and text of subsec. (e). Text read as follows: “This section shall not apply to any market discount bond issued on or before July 18, 1984.”

1988—Subsec. (b)(3). Pub. L. 100-647 designated paragraph relating to special rule where there are partial principal payments as par. (3) and inserted period at end.

1986—Subsec. (a)(3). Pub. L. 99-514, §1803(a)(13)(A)(i), added par. (3). Former par. (3) redesignated (4).

Subsec. (a)(4). Pub. L. 99-514, §1803(a)(13)(A)(i), (ii), redesignated par. (3) as (4) and substituted “under paragraph (1) or (3)” for “under paragraph (1)”.

Subsec. (b). Pub. L. 99-514, §1803(a)(13)(A)(iii), added undesignated par. at end relating to special rule where partial principal payments.

Subsec. (c)(3). Pub. L. 99-514, §631(e)(15), struck out reference to section 334(c).

Subsec. (d)(1)(C). Pub. L. 99-514, §1803(a)(5), added subpar. (C).

Subsec. (e). Pub. L. 99-514, §1899A(28), substituted “July 18, 1984” for “the date of the enactment of this section”.

EFFECTIVE DATE OF 1993 AMENDMENT

Section 13206(b)(3) of Pub. L. 103-66 provided that: “The amendments made by this section [probably should be “subsection”, which amended this section and sections 1277 and 1278 of this title] shall apply to obligations purchased (within the meaning of section 1272(d)(1) of the Internal Revenue Code of 1986) after April 30, 1993.”

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 631(e)(15) of Pub. L. 99-514 applicable to any distribution in complete liquidation, and any sale or exchange, made by a corporation after July 31, 1986, unless such corporation is completely liquidated before Jan. 1, 1987, any transaction described in section 338 of this title for which the acquisition date occurs after Dec. 31, 1986, and any distribution, not in complete liquidation, made after Dec. 31, 1986, with exceptions and special and transitional rules, see section 633 of Pub. L. 99-514, set out as an Effective Date note under section 336 of this title.

Amendment by section 1803(a)(5) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

Section 1803(a)(13)(C) of Pub. L. 99-514 provided that: “The amendments made by this paragraph [amending this section and section 1286 of this title] shall apply to obligations acquired after the date of the enactment of this Act [Oct. 22, 1986].”

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to obligations issued after July 18, 1984, in taxable years ending after such date, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147

and 1171–1177] or title XVIII [§§1800–1899A] of Pub. L. 99–514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99–514, as amended, set out as a note under section 401 of this title.

§ 1277. Deferral of interest deduction allocable to accrued market discount

(a) General rule

Except as otherwise provided in this section, the net direct interest expense with respect to any market discount bond shall be allowed as a deduction for the taxable year only to the extent that such expense exceeds the portion of the market discount allocable to the days during the taxable year on which such bond was held by the taxpayer (as determined under the rules of section 1276(b)).

(b) Disallowed deduction allowed for later years

(1) Election to take into account in later year where net interest income from bond

(A) In general

If—

- (i) there is net interest income for any taxable year with respect to any market discount bond, and
- (ii) the taxpayer makes an election under this subparagraph with respect to such bond,

any disallowed interest expense with respect to such bond shall be treated as interest paid or accrued by the taxpayer during such taxable year to the extent such disallowed interest expense does not exceed the net interest income with respect to such bond.

(B) Determination of disallowed interest expense

For purposes of subparagraph (A), the amount of the disallowed interest expense—

- (i) shall be determined as of the close of the preceding taxable year, and
- (ii) shall not include any amount previously taken into account under subparagraph (A).

(C) Net interest income

For purposes of this paragraph, the term “net interest income” means the excess of the amount determined under paragraph (2) of subsection (c) over the amount determined under paragraph (1) of subsection (c).

(2) Remainder of disallowed interest expense allowed for year of disposition

(A) In general

Except as otherwise provided in this paragraph, the amount of the disallowed interest expense with respect to any market discount bond shall be treated as interest paid or accrued by the taxpayer in the taxable year in which such bond is disposed of.

(B) Nonrecognition transactions

If any market discount bond is disposed of in a nonrecognition transaction—

- (i) the disallowed interest expense with respect to such bond shall be treated as interest paid or accrued in the year of dis-

position only to the extent of the amount of gain recognized on such disposition, and

(ii) the disallowed interest expense with respect to such property (to the extent not so treated) shall be treated as disallowed interest expense—

(I) in the case of a transaction described in section 1276(c)(1), of the transferee with respect to the transferred basis property, or

(II) in the case of a transaction described in section 1276(c)(2), with respect to the exchanged basis property.

(C) Disallowed interest expense reduced for amounts previously taken into account under paragraph (1)

For purposes of this paragraph, the amount of the disallowed interest expense shall not include any amount previously taken into account under paragraph (1).

(3) Disallowed interest expense

For purposes of this subsection, the term “disallowed interest expense” means the aggregate amount disallowed under subsection (a) with respect to the market discount bond.

(c) Net direct interest expense

For purposes of this section, the term “net direct interest expense” means, with respect to any market discount bond, the excess (if any) of—

- (1) the amount of interest paid or accrued during the taxable year on indebtedness which is incurred or continued to purchase or carry such bond, over
- (2) the aggregate amount of interest (including original issue discount) includible in gross income for the taxable year with respect to such bond.

In the case of any financial institution which is a bank (as defined in section 585(a)(2)), the determination of whether interest is described in paragraph (1) shall be made under principles similar to the principles of section 291(e)(1)(B)(ii). Under rules similar to the rules of section 265(a)(5), short sale expenses shall be treated as interest for purposes of determining net direct interest expense.

(Added Pub. L. 98–369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 545; amended Pub. L. 99–514, title IX, §§901(d)(4)(F), §902(e)(2), title XVIII, §1899A(29)–(31), Oct. 22, 1986, 100 Stat. 2380, 2382, 2960; Pub. L. 100–647, title I, §1018(u)(31), Nov. 10, 1988, 102 Stat. 3592; Pub. L. 103–66, title XIII, §13206(b)(1)(B), Aug. 10, 1993, 107 Stat. 465; Pub. L. 104–188, title I, §1616(b)(14), Aug. 20, 1996, 110 Stat. 1857.)

AMENDMENTS

1996—Subsec. (c). Pub. L. 104–188 struck out “or to which section 593 applies” after “585(a)(2))” in closing provisions.

1993—Subsec. (d). Pub. L. 103–66 struck out heading and text of subsec. (d). Text read as follows: “In the case of a market discount bond issued on or before July 18, 1984, any gain recognized by the taxpayer on any disposition of such bond shall be treated as ordinary income to the extent the amount of such gain does not exceed the amount allowable with respect to such bond under subsection (b)(2) for the taxable year in which such bond is disposed of.”

1988—Subsec. (c). Pub. L. 100-647 inserted a closing parenthesis after “section 585(a)(2)”.

1986—Subsec. (b)(1)(C). Pub. L. 99-514, §1899A(29), substituted “this paragraph” for “this paragraph”.

Subsec. (b)(2)(C). Pub. L. 99-514, §1899A(30), substituted “paragraph (1)” for “paragraph 1” in heading.

Subsec. (c). Pub. L. 99-514, §901(d)(4)(F), substituted “which is a bank (as defined in section 585(a)(2) or to which section 593 applies” for “to which section 585 or 593 applies”.

Pub. L. 99-514, §902(e)(2), substituted “section 265(a)(5)” for “section 265(5)”.

Subsec. (d). Pub. L. 99-514, §1899A(31), substituted “July 18, 1984” for “the date of the enactment of this section”.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 applicable to taxable years beginning after Dec. 31, 1995, see section 1616(c) of Pub. L. 104-188, set out as a note under section 593 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103-66 applicable to obligations purchased (within the meaning of section 1272(d)(1) of this title) after Apr. 30, 1993, see section 13206(b)(3) of Pub. L. 103-66, set out as a note under section 1276 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 901(d)(4)(F) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, see section 901(e) of Pub. L. 99-514, set out as a note under section 166 of this title.

Amendment by section 902(e)(2) of Pub. L. 99-514 applicable to taxable years ending after Dec. 31, 1986, with certain exceptions and qualifications, see section 902(f) of Pub. L. 99-514, set out as a note under section 265 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to obligations acquired after July 18, 1984, in taxable years ending after such date, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1278. Definitions and special rules

(a) In general

For purposes of this part—

(1) Market discount bond

(A) In general

Except as provided in subparagraph (B), the term “market discount bond” means any bond having market discount.

(B) Exceptions

The term “market discount bond” shall not include—

(i) Short-term obligations

Any obligation with a fixed maturity date not exceeding 6 months from the date of issue.

(ii) United States savings bonds

Any United States savings bond.

(iii) Installment obligations

Any installment obligation to which section 453B applies.

(C) Section 1277 not applicable to tax-exempt obligations

For purposes of section 1277, the term “market discount bond” shall not include any tax-exempt obligation (as defined in section 1275(a)(3)).

(D) Treatment of bonds acquired at original issue

(i) In general

Except as otherwise provided in this subparagraph or in regulations, the term “market discount bond” shall not include any bond acquired by the taxpayer at its original issue.

(ii) Treatment of bonds acquired for less than issue price

Clause (i) shall not apply to any bond if—

(I) the basis of the taxpayer in such bond is determined under section 1012, and

(II) such basis is less than the issue price of such bond determined under subpart A of this part.

(iii) Bonds acquired in certain reorganizations

Clause (i) shall not apply to any bond issued pursuant to a plan of reorganization (within the meaning of section 368(a)(1)) in exchange for another bond having market discount. Solely for purposes of section 1276, the preceding sentence shall not apply if such other bond was issued on or before July 18, 1984 (the date of the enactment of section 1276) and if the bond issued pursuant to such plan of reorganization has the same term and the same interest rate as such other bond had.

(iv) Treatment of certain transferred basis property

For purposes of clause (i), if the adjusted basis of any bond in the hands of the taxpayer is determined by reference to the adjusted basis of such bond in the hands of a person who acquired such bond at its original issue, such bond shall be treated as acquired by the taxpayer at its original issue.

(2) Market discount

(A) In general

The term “market discount” means the excess (if any) of—

(i) the stated redemption price of the bond at maturity, over

(ii) the basis of such bond immediately after its acquisition by the taxpayer.

(B) Coordination where bond has original issue discount

In the case of any bond having original issue discount, for purposes of subparagraph (A), the stated redemption price of such bond at maturity shall be treated as equal to its revised issue price.

(C) De minimis rule

If the market discount is less than $\frac{1}{4}$ of 1 percent of the stated redemption price of the bond at maturity multiplied by the number of complete years to maturity (after the taxpayer acquired the bond), then the market discount shall be considered to be zero.

(3) Bond

The term “bond” means any bond, debenture, note, certificate, or other evidence of indebtedness.

(4) Revised issue price

The term “revised issue price” means the sum of—

(A) the issue price of the bond, and

(B) the aggregate amount of the original issue discount includible in the gross income of all holders for periods before the acquisition of the bond by the taxpayer (determined without regard to section 1272(a)(7) or (b)(4)) or, in the case of a tax-exempt obligation, the aggregate amount of the original issue discount which accrued in the manner provided by section 1272(a) (determined without regard to paragraph (7) thereof) during periods before the acquisition of the bond by the taxpayer.

(5) Original issue discount, etc.

The terms “original issue discount”, “stated redemption price at maturity”, and “issue price” have the respective meanings given such terms by subpart A of this part.

(b) Election to include market discount currently

(1) In general

If the taxpayer makes an election under this subsection—

(A) sections 1276 and 1277 shall not apply, and

(B) market discount on any market discount bond shall be included in the gross income of the taxpayer for the taxable years to which it is attributable (as determined under the rules of subsection (b) of section 1276).

Except for purposes of sections 103, 871(a),¹ 881, 1441, 1442, and 6049 (and such other provisions as may be specified in regulations), any amount included in gross income under subparagraph (B) shall be treated as interest for purposes of this title.

(2) Scope of election

An election under this subsection shall apply to all market discount bonds acquired by the taxpayer on or after the 1st day of the 1st taxable year to which such election applies.

(3) Period to which election applies

An election under this subsection shall apply to the taxable year for which it is made

and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to the revocation of such election.

(4) Basis adjustment

The basis of any bond in the hands of the taxpayer shall be increased by the amount included in gross income pursuant to this subsection.

(c) Regulations

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subpart, including regulations providing proper adjustments in the case of a bond the principal of which may be paid in 2 or more payments.

(Added and amended Pub. L. 98-369, div. A, title I, § 41(a), title X, § 1001(b)(24), July 18, 1984, 98 Stat. 547; Pub. L. 99-514, title XVIII, §§ 1803(a)(6), 1878(a), 1899A(32), Oct. 22, 1986, 100 Stat. 2793, 2903, 2960; Pub. L. 100-647, title I, §§ 1006(u)(2), 1018(c)(2), (3), Nov. 10, 1988, 102 Stat. 3427, 3578; Pub. L. 103-66, title XIII, § 13206(b)(2), Aug. 10, 1993, 107 Stat. 465.)

AMENDMENTS

1993—Subsec. (a)(1)(B)(ii)–(iv). Pub. L. 103-66, § 13206(b)(2)(A)(i), redesignated cls. (iii) and (iv) as (ii) and (iii), respectively, and struck out heading and text of former cl. (ii). Text read as follows: “Any tax-exempt obligation (as defined in section 1275(a)(3)).”

Subsec. (a)(1)(C), (D). Pub. L. 103-66, § 13206(b)(2)(A)(ii), (iii), added subpar. (C) and redesignated former subpar. (C) as (D).

Subsec. (a)(4)(B). Pub. L. 103-66, § 13206(b)(2)(B)(ii), inserted before period at end “or, in the case of a tax-exempt obligation, the aggregate amount of the original issue discount which accrued in the manner provided by section 1272(a) (determined without regard to paragraph (7) thereof) during periods before the acquisition of the bond by the taxpayer”.

Subsec. (b)(1). Pub. L. 103-66, § 13206(b)(2)(B)(i), substituted “sections 103, 871(a),” for “sections 871(a)” in last sentence.

1988—Subsec. (a)(4)(B). Pub. L. 100-647, § 1006(u)(2), substituted “section 1272(a)(7)” for “section 1272(a)(6)”.

Subsec. (b)(4). Pub. L. 100-647, § 1018(c)(3), added par. (4).

Subsec. (c). Pub. L. 100-647, § 1018(c)(2), inserted before period at end “, including regulations providing proper adjustments in the case of a bond the principal of which may be paid in 2 or more payments”.

1986—Subsec. (a)(1)(B)(i). Pub. L. 99-514, § 1878(a), amended Pub. L. 98-369, § 1001(b), by adding a par. (24) which contained directory language substituting “6 months” for “1 year” in cl. (i). See 1984 Amendment note below.

Subsec. (a)(1)(C). Pub. L. 99-514, § 1803(a)(6), added subpar. (C).

Subsec. (a)(4). Pub. L. 99-514, § 1899A(32), substituted “means” for “means of” in introductory provisions.

1984—Subsec. (a)(1)(B)(i). Pub. L. 98-369, § 1001(b)(24), as added by Pub. L. 99-514, § 1878(a), substituted “6 months” for “1 year”.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendments by Pub. L. 103-66 applicable to obligations purchased (within the meaning of section 1272(d)(1) of this title) after Apr. 30, 1993, see section 13206(b)(3) of Pub. L. 103-66, set out as a note under section 1276 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of

¹ So in original.

the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by sections 1803(a)(6) and 1878(a) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 applicable to property acquired after June 22, 1984, and before Jan. 1, 1988, see section 1001(e) of Pub. L. 98-369, set out as a note under section 166 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, except as otherwise provided, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

SUBPART C—DISCOUNT ON SHORT-TERM OBLIGATIONS

Sec.	
1281.	Current inclusion in income of discount on certain short-term obligations.
1282.	Deferral of interest deduction allocable to accrued discount.
1283.	Definitions and special rules.

§ 1281. Current inclusion in income of discount on certain short-term obligations

(a) General rule

In the case of any short-term obligation to which this section applies, for purposes of this title—

- (1) there shall be included in the gross income of the holder an amount equal to the sum of the daily portions of the acquisition discount for each day during the taxable year on which such holder held such obligation, and
- (2) any interest payable on the obligation (other than interest taken into account in determining the amount of the acquisition discount) shall be included in gross income as it accrues.

(b) Short-term obligations to which section applies

(1) In general

This section shall apply to any short-term obligation which—

- (A) is held by a taxpayer using an accrual method of accounting,
- (B) is held primarily for sale to customers in the ordinary course of the taxpayer's trade or business,
- (C) is held by a bank (as defined in section 581),

(D) is held by a regulated investment company or a common trust fund,

(E) is identified by the taxpayer under section 1256(e)(2) as being part of a hedging transaction, or

(F) is a stripped bond or stripped coupon held by the person who stripped the bond or coupon (or by any other person whose basis is determined by reference to the basis in the hands of such person).

(2) Treatment of obligations held by pass-thru entities

(A) In general

This section shall apply also to—

- (i) any short-term obligation which is held by a pass-thru entity which is formed or availed of for purposes of avoiding the provisions of this section, and
- (ii) any short-term obligation which is acquired by a pass-thru entity (not described in clause (i)) during the required accrual period.

(B) Required accrual period

For purposes of subparagraph (A), the term “required accrual period” means the period—

- (i) which begins with the first taxable year for which the ownership test of subparagraph (C) is met with respect to the pass-thru entity (or a predecessor), and
- (ii) which ends with the first taxable year after the taxable year referred to in clause (i) for which the ownership test of subparagraph (C) is not met and with respect to which the Secretary consents to the termination of the required accrual period.

(C) Ownership test

The ownership test of this subparagraph is met for any taxable year if, on at least 90 days during the taxable year, 20 percent or more of the value of the interests in the pass-thru entity are held by persons described in paragraph (1) or by other pass-thru entities to which subparagraph (A) applies.

(D) Pass-thru entity

The term “pass-thru entity” means any partnership, S corporation, trust, or other pass-thru entity.

(c) Cross reference

For special rules limiting the application of this section to original issue discount in the case of non-governmental obligations, see section 1283(c).

(Added Pub. L. 98-369, div. A, title I, § 41(a), July 18, 1984, 98 Stat. 548; amended Pub. L. 99-514, title XVIII, § 1803(a)(7), (8)(A), Oct. 22, 1986, 100 Stat. 2793, 2794.)

AMENDMENTS

1986—Subsec. (a). Pub. L. 99-514, § 1803(a)(8), amended subsec. (a) generally, designating existing provisions as par. (1) and adding par. (2).

Subsec. (b)(1)(F). Pub. L. 99-514, § 1803(a)(7), added subpar. (F).

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 1803(a)(7) of Pub. L. 99-514 effective, except as otherwise provided, as if included in

the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

Section 1803(a)(8)(A) of Pub. L. 99-514, as amended by Pub. L. 100-647, title I, §1018(c)(1), Nov. 10, 1988, 102 Stat. 3578, provided that the amendment made by section 1803(a)(8)(A) of Pub. L. 99-514 is effective with respect to obligations acquired after Dec. 31, 1985.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to obligations acquired after that date, with certain elections available, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1282. Deferral of interest deduction allocable to accrued discount

(a) General rule

Except as otherwise provided in this section, the net direct interest expense with respect to any short-term obligation shall be allowed as a deduction for the taxable year only to the extent such expense exceeds the sum of—

(1) the daily portions of the acquisition discount for each day during the taxable year on which the taxpayer held such obligation, and

(2) the amount of any interest payable on the obligation (other than interest taken into account in determining the amount of the acquisition discount) which accrues during the taxable year while the taxpayer held such obligation (and is not included in the gross income of the taxpayer for such taxable year by reason of the taxpayer's method of accounting).

(b) Section not to apply to obligations to which section 1281 applies

(1) In general

This section shall not apply to any short-term obligation to which section 1281 applies.

(2) Election to have section 1281 apply to all obligations

(A) In general

A taxpayer may make an election under this paragraph to have section 1281 apply to all short-term obligations acquired by the taxpayer on or after the 1st day of the 1st taxable year to which such election applies.

(B) Period to which election applies

An election under this paragraph shall apply to the taxable year for which it is made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to the revocation of such election.

(c) Certain rules made applicable

Rules similar to the rules of subsections (b) and (c) of section 1277 shall apply for purposes of this section.

(d) Cross reference

For special rules limiting the application of this section to original issue discount in the case of non-governmental obligations, see section 1283(c).

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 549; amended Pub. L. 99-514, title XVIII, §1803(a)(8)(B), Oct. 22, 1986, 100 Stat. 2794.)

AMENDMENTS

1986—Subsec. (a), Pub. L. 99-514 amended subsec. (a) generally, designating existing provisions as par. (1) and adding par. (2).

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and to obligations acquired after that date, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1283. Definitions and special rules

(a) Definitions

For purposes of this subpart—

(1) Short-term obligation

(A) In general

Except as provided in subparagraph (B), the term “short-term obligation” means any bond, debenture, note, certificate, or other evidence of indebtedness which has a fixed maturity date not more than 1 year from the date of issue.

(B) Exceptions for tax-exempt obligations

The term “short-term obligation” shall not include any tax-exempt obligation (as defined in section 1275(a)(3)).

(2) Acquisition discount

The term “acquisition discount” means the excess of—

(A) the stated redemption price at maturity (as defined in section 1273), over

(B) the taxpayer's basis for the obligation.

(b) Daily portion

For purposes of this subpart—

(1) Ratable accrual

Except as otherwise provided in this subsection, the daily portion of the acquisition discount is an amount equal to—

(A) the amount of such discount, divided by

(B) the number of days after the day on which the taxpayer acquired the obligation

and up to (and including) the day of its maturity.

(2) Election of accrual on basis of constant interest rate (in lieu of ratable accrual)

(A) In general

At the election of the taxpayer with respect to any obligation, the daily portion of the acquisition discount for any day is the portion of the acquisition discount accruing on such day determined (under regulations prescribed by the Secretary) on the basis of—

- (i) the taxpayer's yield to maturity based on the taxpayer's cost of acquiring the obligation, and
- (ii) compounding daily.

(B) Election irrevocable

An election under subparagraph (A), once made with respect to any obligation, shall be irrevocable.

(c) Special rules for nongovernmental obligations

(1) In general

In the case of any short-term obligation which is not a short-term Government obligation (as defined in section 1271(a)(3)(B))—

(A) sections 1281 and 1282 shall be applied by taking into account original issue discount in lieu of acquisition discount, and

(B) appropriate adjustments shall be made in the application of subsection (b) of this section.

(2) Election to have paragraph (1) not apply

(A) In general

A taxpayer may make an election under this paragraph to have paragraph (1) not apply to all obligations acquired by the taxpayer on or after the first day of the first taxable year to which such election applies.

(B) Period to which election applies

An election under this paragraph shall apply to the taxable year for which it is made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to the revocation of such election.

(d) Other special rules

(1) Basis adjustments

The basis of any short-term obligation in the hands of the holder thereof shall be increased by the amount included in his gross income pursuant to section 1281.

(2) Double inclusion in income not required

Section 1281 shall not require the inclusion of any amount previously includible in gross income.

(3) Coordination with other provisions

Section 454(b) and paragraphs (3) and (4) of section 1271(a) shall not apply to any short-term obligation to which section 1281 applies.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 549; amended Pub. L. 99-514, title XVIII, §1803(a)(1)(B), Oct. 22, 1986, 100 Stat. 2792.)

AMENDMENTS

1986—Subsec. (d)(3). Pub. L. 99-514 substituted “paragraphs (3) and (4) of section 1271(a)” for “section 1271(a)(3)”.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and to obligations acquired after that date, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

SUBPART D—MISCELLANEOUS PROVISIONS

Sec.	
1286.	Tax treatment of stripped bonds.
1287.	Denial of capital gain treatment for gains on certain obligations not in registered form.
1288.	Treatment of original issue discount on tax-exempt obligations.

§ 1286. Tax treatment of stripped bonds

(a) Inclusion in income as if bond and coupons were original issue discount bonds

If any person purchases after July 1, 1982, a stripped bond or a stripped coupon, then such bond or coupon while held by such purchaser (or by any other person whose basis is determined by reference to the basis in the hands of such purchaser) shall be treated for purposes of this part as a bond originally issued on the purchase date and having an original issue discount equal to the excess (if any) of—

- (1) the stated redemption price at maturity (or, in the case of coupon, the amount payable on the due date of such coupon), over
- (2) such bond's or coupon's ratable share of the purchase price.

For purposes of paragraph (2), ratable shares shall be determined on the basis of their respective fair market values on the date of purchase.

(b) Tax treatment of person stripping bond

For purposes of this subtitle, if any person strips 1 or more coupons from a bond and after July 1, 1982, disposes of the bond or such coupon—

- (1) such person shall include in gross income an amount equal to the sum of—

(A) the interest accrued on such bond while held by such person and before the time such coupon or bond was disposed of (to the extent such interest has not theretofore been included in such person's gross income), and

(B) the accrued market discount on such bond determined as of the time such coupon

or bond was disposed of (to the extent such discount has not theretofore been included in such person's gross income),

(2) the basis of the bond and coupons shall be increased by the amount included in gross income under paragraph (1),

(3) the basis of the bond and coupons immediately before the disposition (as adjusted pursuant to paragraph (2)) shall be allocated among the items retained by such person and the items disposed of by such person on the basis of their respective fair market values, and

(4) for purposes of subsection (a), such person shall be treated as having purchased on the date of such disposition each such item which he retains for an amount equal to the basis allocated to such item under paragraph (3).

A rule similar to the rule of paragraph (4) shall apply in the case of any person whose basis in any bond or coupon is determined by reference to the basis of the person described in the preceding sentence.

(c) Retention of existing law for stripped bonds purchased before July 2, 1982

If a bond issued at any time with interest coupons—

(1) is purchased after August 16, 1954, and before January 1, 1958, and the purchaser does not receive all the coupons which first become payable more than 12 months after the date of the purchase, or

(2) is purchased after December 31, 1957, and before July 2, 1982, and the purchaser does not receive all the coupons which first become payable after the date of the purchase,

then the gain on the sale or other disposition of such bond by such purchaser (or by a person whose basis is determined by reference to the basis in the hands of such purchaser) shall be considered as ordinary income to the extent that the fair market value (determined as of the time of the purchase) of the bond with coupons attached exceeds the purchase price. If this subsection and section 1271(a)(2)(A) apply with respect to gain realized on the sale or exchange of any evidence of indebtedness, then section 1271(a)(2)(A) shall apply with respect to that part of the gain to which this subsection does not apply.

(d) Special rules for tax-exempt obligations

(1) In general

In the case of any tax-exempt obligation (as defined in section 1275(a)(3)) from which 1 or more coupons have been stripped—

(A) the amount of the original issue discount determined under subsection (a) with respect to any stripped bond or stripped coupon—

(i) shall be treated as original issue discount on a tax-exempt obligation to the extent such discount does not exceed the tax-exempt portion of such discount, and

(ii) shall be treated as original issue discount on an obligation which is not a tax-exempt obligation to the extent such discount exceeds the tax-exempt portion of such discount,

(B) subsection (b)(1)(A) shall not apply, and

(C) subsection (b)(2) shall be applied by increasing the basis of the bond or coupon by the sum of—

(i) the interest accrued but not paid before such bond or coupon was disposed of (and not previously reflected in basis), plus

(ii) the amount included in gross income under subsection (b)(1)(B).

(2) Tax-exempt portion

For purposes of paragraph (1), the tax-exempt portion of the original issue discount determined under subsection (a) is the excess of—

(A) the amount referred to in subsection (a)(1), over

(B) an issue price which would produce a yield to maturity as of the purchase date equal to the lower of—

(i) the coupon rate of interest on the obligation from which the coupons were separated, or

(ii) the yield to maturity (on the basis of the purchase price) of the stripped obligation or coupon.

The purchaser of any stripped obligation or coupon may elect to apply clause (i) by substituting "original yield to maturity of" for "coupon rate of interest on".

(e) Definitions and special rules

For purposes of this section—

(1) Bond

The term "bond" means a bond, debenture, note, or certificate or other evidence of indebtedness.

(2) Stripped bond

The term "stripped bond" means a bond issued at any time with interest coupons where there is a separation in ownership between the bond and any coupon which has not yet become payable.

(3) Stripped coupon

The term "stripped coupon" means any coupon relating to a stripped bond.

(4) Stated redemption price at maturity

The term "stated redemption price at maturity" has the meaning given such term by section 1273(a)(2).

(5) Coupon

The term "coupon" includes any right to receive interest on a bond (whether or not evidenced by a coupon). This paragraph shall apply for purposes of subsection (c) only in the case of purchases after July 1, 1982.

(6) Purchase

The term "purchase" has the meaning given such term by section 1272(d)(1).

(f) Treatment of stripped interests in bond and preferred stock funds, etc.

In the case of an account or entity substantially all of the assets of which consist of bonds, preferred stock, or a combination thereof, the Secretary may by regulations provide that rules similar to the rules of this section and 305(e),¹ as

¹ So in original. Probably should be "section 305(e)".

appropriate, shall apply to interests in such account or entity to which (but for this subsection) this section or section 305(e), as the case may be, would not apply.

(g) Regulation authority

The Secretary may prescribe regulations providing that where, by reason of varying rates of interest, put or call options, or other circumstances, the tax treatment under this section does not accurately reflect the income of the holder of a stripped coupon or stripped bond, or of the person disposing of such bond or coupon, as the case may be, for any period, such treatment shall be modified to require that the proper amount of income be included for such period.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 551; amended Pub. L. 99-514, title XVIII, §§1803(a)(13)(B), 1879(s)(1), Oct. 22, 1986, 100 Stat. 2796, 2912; Pub. L. 100-647, title I, §1018(q)(4)(A), Nov. 10, 1988, 102 Stat. 3585; Pub. L. 108-357, title VIII, §831(a), Oct. 22, 2004, 118 Stat. 1587.)

AMENDMENTS

2004—Subsecs. (f), (g). Pub. L. 108-357 added subsec. (f) and redesignated former subsec. (f) as (g).

1988—Subsec. (d). Pub. L. 100-647 amended subsec. (d) generally. Prior to amendment, subsec. (d) read as follows: “In the case of any tax-exempt obligation (as defined in section 1275(a)(3)) from which 1 or more coupons have been stripped—

“(1) the amount of original issue discount determined under subsection (a) with respect to any stripped bond or stripped coupon from such obligation shall be the amount which produces a yield to maturity (as of the purchase date) equal to the lower of—

“(A) the coupon rate of interest on such obligation before the separation of coupons, or

“(B) the yield to maturity (on the basis of purchase price) of the stripped obligation or coupon.

“(2) the amount of original issue discount determined under paragraph (1) shall be taken into account in determining the adjusted basis of the holder under section 1288.

“(3) subsection (b)(1) shall not apply, and

“(4) subsection (b)(2) shall be applied by increasing the basis of the bond or coupon by the interest accrued but not paid before the time such bond or coupon was disposed of (and not previously reflected in basis).”

1986—Subsec. (b)(1). Pub. L. 99-514, §1803(a)(13)(B)(i), amended par. (1) generally, designating existing provisions as subpar. (A) and adding subpar. (B).

Subsec. (b)(2). Pub. L. 99-514, §1803(a)(13)(B)(ii), substituted “the amount included in gross income under paragraph (1)” for “the amount of the accrued interest described in paragraph (1)”.

Subsec. (d). Pub. L. 99-514, §1879(s)(1), amended subsec. (d) generally. Prior to amendment, subsec. (d) read as follows: “In the case of any tax-exempt obligation (as defined in section 1275(a)(3))—

“(1) subsections (a) and (b)(1) shall not apply,

“(2) the rules of subsection (b)(4) shall apply for purposes of subsection (c), and

“(3) subsection (c) shall be applied without regard to the requirement that the bond be purchased before July 2, 1982.”

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to purchases and dispositions after Oct. 22, 2004, see section 831(c) of Pub. L. 108-357, set out as a note under section 305 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Section 1018(q)(4)(B) of Pub. L. 100-647 provided that:

“(i) Except as provided in clause (ii), the amendment made by subparagraph (A) [amending this section] shall apply to any purchase or sale after June 10, 1987, of any stripped tax-exempt obligation or stripped coupon from such an obligation.

“(ii) If—

“(I) any person held any obligation or coupon in stripped form on June 10, 1987, and

“(II) such obligation or coupon was held by such person on such date for sale in the ordinary course of such person’s trade or business,

the amendment made by subparagraph (A) shall not apply to any sale of such obligation or coupon by such person and shall not apply to any such obligation or coupon while held by another person who purchased such obligation or coupon from the person referred to in subclause (I).”

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 1803(a)(13)(B) of Pub. L. 99-514 applicable to obligations acquired after Oct. 22, 1986, see section 1803(a)(13)(C) of Pub. L. 99-514, set out as a note under section 1276 of this title.

Section 1879(s)(2) of Pub. L. 99-514 provided that: “The amendment made by paragraph (1) [amending this section] shall apply to any purchase or sale of any stripped tax-exempt obligation or stripped coupon from such an obligation after the date of the enactment of this Act [Oct. 22, 1986].”

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, except as otherwise provided, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

**PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989**

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1287. Denial of capital gain treatment for gains on certain obligations not in registered form

(a) In general

If any registration-required obligation is not in registered form, any gain on the sale or other disposition of such obligation shall be treated as ordinary income (unless the issuance of such obligation was subject to tax under section 4701).

(b) Definitions

For purposes of subsection (a)—

(1) Registration-required obligation

The term “registration-required obligation” has the meaning given to such term by section 163(f)(2).

(2) Registered form

The term “registered form” has the same meaning as when used in section 163(f).

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 552; amended Pub. L. 111-147, title V, §502(a)(2)(D), Mar. 18, 2010, 124 Stat. 107.)

AMENDMENTS

2010—Subsec. (b)(1). Pub. L. 111-147 struck out “except that clause (iv) of subparagraph (A), and subparagraph (B), of such section shall not apply” before period.

EFFECTIVE DATE OF 2010 AMENDMENT

Amendment by Pub. L. 111-147 applicable to obligations issued after the date which is 2 years after Mar. 18, 2010, see section 502(f) of Pub. L. 111-147, set out as a note under section 149 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, except as otherwise provided, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

§ 1288. Treatment of original issue discount on tax-exempt obligations

(a) General rule

Original issue discount on any tax-exempt obligation shall be treated as accruing—

(1) for purposes of section 163, in the manner provided by section 1272(a) (determined with-out regard to paragraph (7) thereof), and

(2) for purposes of determining the adjusted basis of the holder, in the manner provided by section 1272(a) (determined with regard to paragraph (7) thereof).

(b) Definitions and special rules

For purposes of this section—

(1) Original issue discount

The term “original issue discount” has the meaning given to such term by section 1273(a) without regard to paragraph (3) thereof. In applying section 483 or 1274, under regulations prescribed by the Secretary, appropriate adjustments shall be made to the applicable Federal rate to take into account the tax exemption for interest on the obligation.

(2) Tax-exempt obligation

The term “tax-exempt obligation” has the meaning given to such term by section 1275(a)(3).

(3) Short-term obligations

In applying this section to obligations with maturity of 1 year or less, rules similar to the rules of section 1283(b) shall apply.

(Added Pub. L. 98-369, div. A, title I, §41(a), July 18, 1984, 98 Stat. 553; amended Pub. L. 100-647, title I, §1006(u)(3), Nov. 10, 1988, 102 Stat. 3427.)

AMENDMENTS

1988—Subsec. (a). Pub. L. 100-647 substituted “paragraph (7)” for “paragraph (6)” in pars. (1) and (2).

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable to taxable years ending after July 18, 1984, and applicable to obligations issued after Sept. 3, 1982, and acquired after Mar. 1, 1984, see section 44 of Pub. L. 98-369, set out as a note under section 1271 of this title.

PART VI—TREATMENT OF CERTAIN PASSIVE FOREIGN INVESTMENT COMPANIES

Subpart

A. Interest on tax deferral.

Subpart

- B. Treatment of qualified electing funds.
- C. Election of mark to market for marketable stock.
- D. General provisions.

AMENDMENTS

1997—Pub. L. 105-34, title XI, §1122(d)(6), Aug. 5, 1997, 111 Stat. 977, added items for subparts C and D and struck out former item for subpart C “General provisions”.

SUBPART A—INTEREST ON TAX DEFERRAL

Sec.

1291. Interest on tax deferral.

§ 1291. Interest on tax deferral

(a) Treatment of distributions and stock dispositions

(1) Distributions

If a United States person receives an excess distribution in respect of stock in a passive foreign investment company, then—

(A) the amount of the excess distribution shall be allocated ratably to each day in the taxpayer's holding period for the stock,

(B) with respect to such excess distribution, the taxpayer's gross income for the current year shall include (as ordinary income) only the amounts allocated under subparagraph (A) to—

(i) the current year, or

(ii) any period in the taxpayer's holding period before the 1st day of the 1st taxable year of the company which begins after December 31, 1986, and for which it was a passive foreign investment company, and

(C) the tax imposed by this chapter for the current year shall be increased by the deferred tax amount (determined under subsection (c)).

(2) Dispositions

If the taxpayer disposes of stock in a passive foreign investment company, then the rules of paragraph (1) shall apply to any gain recognized on such disposition in the same manner as if such gain were an excess distribution.

(3) Definitions

For purposes of this section—

(A) Holding period

The taxpayer's holding period shall be determined under section 1223; except that—

(i) for purposes of applying this section to an excess distribution, such holding period shall be treated as ending on the date of such distribution, and

(ii) if section 1296 applied to such stock with respect to the taxpayer for any prior taxable year, such holding period shall be treated as beginning on the first day of the first taxable year beginning after the last taxable year for which section 1296 so applied.

(B) Current year

The term “current year” means the taxable year in which the excess distribution or disposition occurs.

(b) Excess distribution**(1) In general**

For purposes of this section, the term “excess distribution” means any distribution in respect of stock received during any taxable year to the extent such distribution does not exceed its ratable portion of the total excess distribution (if any) for such taxable year.

(2) Total excess distribution

For purposes of this subsection—

(A) In general

The term “total excess distribution” means the excess (if any) of—

(i) the amount of the distributions in respect of the stock received by the taxpayer during the taxable year, over

(ii) 125 percent of the average amount received in respect of such stock by the taxpayer during the 3 preceding taxable years (or, if shorter, the portion of the taxpayer’s holding period before the taxable year).

For purposes of clause (ii), any excess distribution received during such 3-year period shall be taken into account only to the extent it was included in gross income under subsection (a)(1)(B).

(B) No excess for 1st year

The total excess distributions with respect to any stock shall be zero for the taxable year in which the taxpayer’s holding period in such stock begins.

(3) Adjustments

Under regulations prescribed by the Secretary—

(A) determinations under this subsection shall be made on a share-by-share basis, except that shares with the same holding period may be aggregated,

(B) proper adjustments shall be made for stock splits and stock dividends,

(C) if the taxpayer does not hold the stock during the entire taxable year, distributions received during such year shall be annualized,

(D) if the taxpayer’s holding period includes periods during which the stock was held by another person, distributions received by such other person shall be taken into account as if received by the taxpayer,

(E) if the distributions are received in a foreign currency, determinations under this subsection shall be made in such currency and the amount of any excess distribution determined in such currency shall be translated into dollars,

(F) proper adjustment shall be made for amounts not includible in gross income by reason of section 959(a) or 1293(c), and

(G) if a charitable deduction was allowable under section 642(c) to a trust for any distribution of its income, proper adjustments shall be made for the deduction so allowable to the extent allocable to distributions or gain in respect of stock in a passive foreign investment company.

(c) Deferred tax amount

For purposes of this section—

(1) In general

The term “deferred tax amount” means, with respect to any distribution or disposition to which subsection (a) applies, an amount equal to the sum of—

(A) the aggregate increases in taxes described in paragraph (2), plus

(B) the aggregate amount of interest (determined in the manner provided under paragraph (3)) on such increases in tax.

Any increase in the tax imposed by this chapter for the current year under subsection (a) to the extent attributable to the amount referred to in subparagraph (B) shall be treated as interest paid under section 6601 on the due date for the current year.

(2) Aggregate increases in taxes

For purposes of paragraph (1)(A), the aggregate increases in taxes shall be determined by multiplying each amount allocated under subsection (a)(1)(A) to any taxable year (other than any taxable year referred to in subsection (a)(1)(B)) by the highest rate of tax in effect for such taxable year under section 1 or 11, whichever applies.

(3) Computation of interest**(A) In general**

The amount of interest referred to in paragraph (1)(B) on any increase determined under paragraph (2) for any taxable year shall be determined for the period—

(i) beginning on the due date for such taxable year, and

(ii) ending on the due date for the taxable year with or within which the distribution or disposition occurs,

by using the rates and method applicable under section 6621 for underpayments of tax for such period.

(B) Due date

For purposes of this subsection, the term “due date” means the date prescribed by law (determined without regard to extensions) for filing the return of the tax imposed by this chapter for the taxable year.

(d) Coordination with subparts B and C**(1) In general**

This section shall not apply with respect to any distribution paid by a passive foreign investment company, or any disposition of stock in a passive foreign investment company, if such company is a qualified electing fund with respect to the taxpayer for each of its taxable years—

(A) which begins after December 31, 1986, and for which such company is a passive foreign investment company, and

(B) which includes any portion of the taxpayer’s holding period.

Except as provided in section 1296(j), this section also shall not apply if an election under section 1296(k) is in effect for the taxpayer’s taxable year. In the case of stock which is marked to market under section 475 or any other provision of this chapter, this section shall not apply, except that rules similar to the rules of section 1296(j) shall apply.

(2) Election to recognize gain where company becomes qualified electing fund

(A) In general

If—

(i) a passive foreign investment company becomes a qualified electing fund with respect to the taxpayer for a taxable year which begins after December 31, 1986,

(ii) the taxpayer holds stock in such company on the first day of such taxable year, and

(iii) the taxpayer establishes to the satisfaction of the Secretary the fair market value of such stock on such first day,

the taxpayer may elect to recognize gain as if he sold such stock on such first day for such fair market value.

(B) Additional election for shareholder of controlled foreign corporations

(i) In general

If—

(I) a passive foreign investment company becomes a qualified electing fund with respect to the taxpayer for a taxable year which begins after December 31, 1986,

(II) the taxpayer holds stock in such company on the first day of such taxable year, and

(III) such company is a controlled foreign corporation (as defined in section 957(a)),

the taxpayer may elect to include in gross income as a dividend received on such first day an amount equal to the portion of the post-1986 earnings and profits of such company attributable (under regulations prescribed by the Secretary) to the stock in such company held by the taxpayer on such first day. The amount treated as a dividend under the preceding sentence shall be treated as an excess distribution and shall be allocated under subsection (a)(1)(A) only to days during periods taken into account in determining the post-1986 earnings and profits so attributable.

(ii) Post-1986 earnings and profits

For purposes of clause (i), the term “post-1986 earnings and profits” means earnings and profits which were accumulated in taxable years of such company beginning after December 31, 1986, and during the period or periods the stock was held by the taxpayer while the company was a passive foreign investment company.

(iii) Coordination with section 959(e)

For purposes of section 959(e), any amount included in gross income under this subparagraph shall be treated as included in gross income under section 1248(a).

(C) Adjustments

In the case of any stock to which subparagraph (A) or (B) applies—

(i) the adjusted basis of such stock shall be increased by the gain recognized under

subparagraph (A) or the amount treated as a dividend under subparagraph (B), as the case may be, and

(ii) the taxpayer's holding period in such stock shall be treated as beginning on the first day referred to in such subparagraph.

(e) Certain basis, etc., rules made applicable

Except to the extent inconsistent with the regulations prescribed under subsection (f), rules similar to the rules of subsections (c) and (d) (e),¹ of section 1246 (as in effect on the day before the date of the enactment of the American Jobs Creation Act of 2004) shall apply for purposes of this section; except that—

(1) the reduction under subsection (e) of such section shall be the excess of the basis determined under section 1014 over the adjusted basis of the stock immediately before the decedent's death, and

(2) such a reduction shall not apply in the case of a decedent who was a nonresident alien at all times during his holding period in the stock.

(f) Recognition of gain

To the extent provided in regulations, in the case of any transfer of stock in a passive foreign investment company where (but for this subsection) there is not full recognition of gain, the excess (if any) of—

- (1) the fair market value of such stock, over
- (2) its adjusted basis,

shall be treated as gain from the sale or exchange of such stock and shall be recognized notwithstanding any provision of law. Proper adjustment shall be made to the basis of any such stock for gain recognized under the preceding sentence.

(g) Coordination with foreign tax credit rules

(1) In general

If there are creditable foreign taxes with respect to any distribution in respect of stock in a passive foreign investment company—

(A) the amount of such distribution shall be determined for purposes of this section with regard to section 78,

(B) the excess distribution taxes shall be allocated ratably to each day in the taxpayer's holding period for the stock, and

(C) to the extent—

(i) that such excess distribution taxes are allocated to a taxable year referred to in subsection (a)(1)(B), such taxes shall be taken into account under section 901 for the current year, and

(ii) that such excess distribution taxes are allocated to any other taxable year, such taxes shall reduce (subject to the principles of section 904(d) and not below zero) the increase in tax determined under subsection (c)(2) for such taxable year by reason of such distribution (but such taxes shall not be taken into account under section 901).

(2) Definitions

For purposes of this subsection—

¹ So in original. See 2010 Amendment notes below.

(A) Creditable foreign taxes

The term “creditable foreign taxes” means, with respect to any distribution—

(i) any foreign taxes deemed paid under section 902 with respect to such distribution, and

(ii) any withholding tax imposed with respect to such distribution,

but only if the taxpayer chooses the benefits of section 901 and such taxes are creditable under section 901 (determined without regard to paragraph (1)(C)(ii)).

(B) Excess distribution taxes

The term “excess distribution taxes” means, with respect to any distribution, the portion of the creditable foreign taxes with respect to such distribution which is attributable (on a pro rata basis) to the portion of such distribution which is an excess distribution.

(C) Section 1248 gain

The rules of this subsection also shall apply in the case of any gain which but for this section would be includible in gross income as a dividend under section 1248.

(Added Pub. L. 99-514, title XII, § 1235(a), Oct. 22, 1986, 100 Stat. 2566; amended Pub. L. 100-647, title I, § 1012(p)(1), (3), (6), (7), (9), (12)–(14), (28), (31), (33), title VI, § 6127(b), Nov. 10, 1988, 102 Stat. 3515–3517, 3520, 3521, 3715; Pub. L. 105-34, title XI, § 1122(b), Aug. 5, 1997, 111 Stat. 976; Pub. L. 105-206, title VI, § 6011(c)(2), July 22, 1998, 112 Stat. 818; Pub. L. 107-16, title V, § 542(e)(5)(B), June 7, 2001, 115 Stat. 85; Pub. L. 108-357, title IV, § 413(c)(24), Oct. 22, 2004, 118 Stat. 1509; Pub. L. 111-147, title V, § 521(b), Mar. 18, 2010, 124 Stat. 112; Pub. L. 111-312, title III, § 301(a), Dec. 17, 2010, 124 Stat. 3300.)

AMENDMENT OF SECTION

For termination of amendment by section 304 of Pub. L. 111-312, see Effective and Termination Dates of 2010 Amendment note below.

For termination of amendment by section 901 of Pub. L. 107-16, see Effective and Termination Dates of 2001 Amendment note below.

REFERENCES IN TEXT

The date of the enactment of the American Jobs Creation Act of 2004, referred to in subsec. (e), is the date of enactment of Pub. L. 108-357, which was approved Oct. 22, 2004.

AMENDMENTS

2010—Subsec. (e). Pub. L. 111-312, §§ 301(a), 304, which directed that subsec. (e) be temporarily amended to read as if amended by Pub. L. 107-16, § 542(e)(5)(B), had never been enacted, was executed by inserting “(e),” after “subsections (c) and (d)” and substituting “; except that—” and pars. (1) and (2) for the period at end. See 2001 Amendment note and Effective and Termination Dates of 2010 Amendment note below.

Pub. L. 111-147 substituted “and (d)” for “; (d), and (f)”.

2004—Subsec. (b)(3)(F). Pub. L. 108-357, § 413(c)(24)(A), substituted “959(a)” for “551(d), 959(a).”.

Subsec. (e). Pub. L. 108-357, § 413(c)(24)(B), inserted “(as in effect on the day before the date of the enactment of the American Jobs Creation Act of 2004)” after “section 1246” in introductory provisions.

2001—Subsec. (e). Pub. L. 107-16, §§ 542(e)(5)(B), 901, temporarily struck out “(e),” after “subsections (c), (d),” and substituted period at end for “; except that—

“(1) the reduction under subsection (e) of such section shall be the excess of the basis determined under section 1014 over the adjusted basis of the stock immediately before the decedent’s death, and

“(2) such a reduction shall not apply in the case of a decedent who was a nonresident alien at all times during his holding period in the stock.”

See Effective and Termination Dates of 2001 Amendment note below.

1998—Subsec. (d)(1). Pub. L. 105-206 inserted at end “In the case of stock which is marked to market under section 475 or any other provision of this chapter, this section shall not apply, except that rules similar to the rules of section 1296(j) shall apply.”

1997—Subsec. (a)(3)(A). Pub. L. 105-34, § 1122(b)(3), amended heading and text of subpar. (A) generally. Prior to amendment, text read as follows: “The taxpayer’s holding period shall be determined under section 1223; except that, for purposes of applying this section to an excess distribution, such holding period shall be treated as ending on the date of such distribution.”

Subsec. (d). Pub. L. 105-34, § 1122(b)(2), substituted “subparts B and C” for “subpart B” in heading.

Subsec. (d)(1). Pub. L. 105-34, § 1122(b)(1), inserted concluding provisions.

1988—Subsec. (a)(1)(B)(ii). Pub. L. 100-647, § 1012(p)(12), amended cl. (ii) generally. Prior to amendment, cl. (ii) read as follows: “any period in the taxpayer’s holding period before the 1st day of the 1st taxable year of the company for which it was a passive foreign investment company (or, if later, January 1, 1987), and”.

Subsec. (a)(3)(A). Pub. L. 100-647, § 1012(p)(14), substituted “for purposes of applying this section to” for “in the case of”.

Subsec. (a)(4), (5). Pub. L. 100-647, § 1012(p)(7)(A), struck out par. (4) which related to coordination with section 904, and par. (5) which related to section 902 not applying.

Subsec. (b)(2)(A). Pub. L. 100-647, § 1012(p)(13), inserted at end “For purposes of clause (ii), any excess distribution received during such 3-year period shall be taken into account only to the extent it was included in gross income under subsection (a)(1)(B).”

Subsec. (b)(3)(F). Pub. L. 100-647, § 1012(p)(3), added subpar. (F).

Subsec. (b)(3)(G). Pub. L. 100-647, § 1012(p)(33), added subpar. (G).

Subsec. (c)(1). Pub. L. 100-647, § 1012(p)(31), inserted at end “Any increase in the tax imposed by this chapter for the current year under subsection (a) to the extent attributable to the amount referred to in subparagraph (B) shall be treated as interest paid under section 6601 on the due date for the current year.”

Subsec. (d)(1). Pub. L. 100-647, § 6127(b)(1), inserted “with respect to the taxpayer” after “qualified electing fund”.

Pub. L. 100-647, § 1012(p)(1), amended par. (1) generally. Prior to amendment, par. (1) read as follows: “This section shall not apply with respect to—

“(A) any distribution paid by a passive foreign investment company during a taxable year for which such company is a qualified electing fund, and

“(B) any disposition of stock in a passive foreign investment company if such company is a qualified electing fund for each of its taxable years—

“(i) which begins after December 31, 1986, and for which such company is a passive foreign investment company, and

“(ii) which includes any portion of the taxpayer’s holding period.”

Subsec. (d)(2)(A)(i). Pub. L. 100-647, § 6127(b)(2), inserted “with respect to the taxpayer” after “qualified electing fund”.

Subsec. (d)(2)(B). Pub. L. 100-647, § 1012(p)(28), added subpar. (B) and struck out former subpar. (B) which related to adjustments to basis of stock to which subpar. (A) applies.

Subsec. (d)(2)(B)(i)(I). Pub. L. 100-647, § 6127(b)(2), inserted “with respect to the taxpayer” after “qualified electing fund”.

Subsec. (d)(2)(C). Pub. L. 100-647, §1012(p)(28), added subpar. (C).

Subsec. (e). Pub. L. 100-647, §1012(p)(6)(B), substituted “Except to the extent inconsistent with the regulations prescribed under subsection (f), rules similar”.

Subsec. (e)(2). Pub. L. 100-647, §1012(p)(9), struck out “not” before “a nonresident”.

Subsec. (f). Pub. L. 100-647, §1012(p)(6)(A), amended subsec. (f) generally. Prior to amendment, subsec. (f), “Nonrecognition provisions”, read as follows: “To the extent provided in regulations, gain shall be recognized on any disposition of stock in a passive foreign investment company.”

Subsec. (g). Pub. L. 100-647, §1012(p)(7)(B), added subsec. (g).

EFFECTIVE AND TERMINATION DATES OF 2010 AMENDMENT

Amendment by Pub. L. 111-312 applicable to estates of decedents dying, and transfers made after Dec. 31, 2009, except as otherwise provided, see section 301(e) of Pub. L. 111-312, set out as a note under section 121 of this title.

Section 901 of Pub. L. 107-16 applicable to amendments by section 301(a) of Pub. L. 111-312, see section 304 of Pub. L. 111-312, set out as a note under section 121 of this title.

Pub. L. 111-147, title V, §521(c), Mar. 18, 2010, 124 Stat. 112, provided that: “The amendments made by this section [amending this section and section 1298 of this title] take effect on the date of the enactment of this Act [Mar. 18, 2010].”

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108-357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE AND TERMINATION DATES OF 2001 AMENDMENT

Amendment by Pub. L. 107-16 applicable to estates of decedents dying after Dec. 31, 2009, see section 542(f)(1) of Pub. L. 107-16, set out as a note under section 121 of this title.

Amendment by Pub. L. 107-16 inapplicable to estates of decedents dying, gifts made, or generation skipping transfers, after Dec. 31, 2012, and the Internal Revenue Code of 1986 to be applied and administered to such estates, gifts, and transfers as if such amendment had never been enacted, see section 901 of Pub. L. 107-16, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1998 AMENDMENT

Amendment by Pub. L. 105-206 effective, except as otherwise provided, as if included in the provisions of the Taxpayer Relief Act of 1997, Pub. L. 105-34, to which such amendment relates, see section 6024 of Pub. L. 105-206, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 applicable to taxable years of United States persons beginning after Dec. 31, 1997, and to taxable years of foreign corporations ending with or within such taxable years of United States persons, see section 1124 of Pub. L. 105-34, set out as a note under section 532 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by section 1012(p)(1), (3), (6), (7), (9), (12)–(14), (28), (31), (33) of Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

Amendment by section 6127(b) of Pub. L. 100-647 effective as if included in the amendments made by section 1235 of Pub. L. 99-514, see section 6127(c)(1) of Pub. L. 100-647, set out as a note under section 1295 of this title.

EFFECTIVE DATE

Section 1235(h) of Pub. L. 99-514 provided that: “The amendments made by this section [enacting this section and sections 1293 to 1297 of this title and amending sections 532, 542, 551, 851, 904, 951, 1246, and 6503 of this title] shall apply to taxable years of foreign corporations beginning after December 31, 1986.”

SUBPART B—TREATMENT OF QUALIFIED ELECTING FUNDS

Sec. 1293.	Current taxation of income from qualified electing funds.
1294.	Election to extend time for payment of tax on undistributed earnings.
1295.	Qualified electing fund.

§ 1293. Current taxation of income from qualified electing funds

(a) Inclusion

(1) In general

Every United States person who owns (or is treated under section 1298(a) as owning) stock of a qualified electing fund at any time during the taxable year of such fund shall include in gross income—

(A) as ordinary income, such shareholder's pro rata share of the ordinary earnings of such fund for such year, and

(B) as long-term capital gain, such shareholder's pro rata share of the net capital gain of such fund for such year.

(2) Year of inclusion

The inclusion under paragraph (1) shall be for the taxable year of the shareholder in which or with which the taxable year of the fund ends.

(b) Pro rata share

The pro rata share referred to in subsection (a) in the case of any shareholder is the amount which would have been distributed with respect to the shareholder's stock if, on each day during the taxable year of the fund, the fund had distributed to each shareholder a pro rata share of that day's ratable share of the fund's ordinary earnings and net capital gain for such year. To the extent provided in regulations, if the fund establishes to the satisfaction of the Secretary that it uses a shorter period than the taxable year to determine shareholders' interests in the earnings of such fund, pro rata shares may be determined by using such shorter period.

(c) Previously taxed amounts distributed tax free

If the taxpayer establishes to the satisfaction of the Secretary that any amount distributed by a passive foreign investment company is paid out of earnings and profits of the company which were included under subsection (a) in the income of any United States person, such amount shall be treated, for purposes of this chapter, as a distribution which is not a dividend; except that such distribution shall immediately reduce earnings and profits. If the passive foreign investment company is a controlled

foreign corporation (as defined in section 957(a)), the preceding sentence shall not apply to any United States shareholder (as defined in section 951(b)) in such corporation, and, in applying section 959 to any such shareholder, any inclusion under this section shall be treated as an inclusion under section 951(a)(1)(A).

(d) Basis adjustments

The basis of the taxpayer's stock in a passive foreign investment company shall be—

- (1) increased by any amount which is included in the income of the taxpayer under subsection (a) with respect to such stock, and
- (2) decreased by any amount distributed with respect to such stock which is not includible in the income of the taxpayer by reason of subsection (c).

A similar rule shall apply also in the case of any property if by reason of holding such property the taxpayer is treated under section 1298(a) as owning stock in a qualified electing fund.

(e) Ordinary earnings

For purposes of this section—

(1) Ordinary earnings

The term “ordinary earnings” means the excess of the earnings and profits of the qualified electing fund for the taxable year over its net capital gain for such taxable year.

(2) Limitation on net capital gain

A qualified electing fund's net capital gain for any taxable year shall not exceed its earnings and profits for such taxable year.

(3) Determination of earnings and profits

The earnings and profits of any qualified electing fund shall be determined without regard to paragraphs (4), (5), and (6) of section 312(n). Under regulations, the preceding sentence shall not apply to the extent it would increase earnings and profits by an amount which was previously distributed by the qualified electing fund.

(f) Foreign tax credit allowed in the case of 10-percent corporate shareholder

For purposes of section 960—

- (1) any amount included in the gross income under subsection (a) shall be treated as if it were included under section 951(a), and
- (2) any amount excluded from gross income under subsection (c) shall be treated in the same manner as amounts excluded from gross income under section 959.

(g) Other special rules

(1) Exception for certain income

For purposes of determining the amount included in the gross income of any person under this section, the ordinary earnings and net capital gain of a qualified electing fund shall not include any item of income received by such fund if—

- (A) such fund is a controlled foreign corporation (as defined in section 957(a)) and such person is a United States shareholder (as defined in section 951(b)) in such fund, and
- (B) such person establishes to the satisfaction of the Secretary that—

- (i) such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in section 11, or

- (ii) such income is—

- (I) from sources within the United States,

- (II) effectively connected with the conduct by the qualified electing fund of a trade or business in the United States, and

- (III) not exempt from taxation (or subject to a reduced rate of tax) pursuant to a treaty obligation of the United States.

(2) Prevention of double inclusion

The Secretary shall prescribe such adjustment to the provisions of this section as may be necessary to prevent the same item of income of a qualified electing fund from being included in the gross income of a United States person more than once.

(Added Pub. L. 99-514, title XII, §1235(a), Oct. 22, 1986, 100 Stat. 2569; amended Pub. L. 100-647, title I, §1012(p)(15), (18), (23), (32), Nov. 10, 1988, 102 Stat. 3518, 3519, 3521; Pub. L. 103-66, title XIII, §13231(c)(3), Aug. 10, 1993, 107 Stat. 498; Pub. L. 105-34, title XI, §1122(d)(3), Aug. 5, 1997, 111 Stat. 977.)

AMENDMENTS

1997—Subsecs. (a)(1), (d). Pub. L. 105-34 substituted “section 1298(a)” for “section 1297(a)”.

1993—Subsec. (c). Pub. L. 103-66 inserted at end “If the passive foreign investment company is a controlled foreign corporation (as defined in section 957(a)), the preceding sentence shall not apply to any United States shareholder (as defined in section 951(b)) in such corporation, and, in applying section 959 to any such shareholder, any inclusion under this section shall be treated as an inclusion under section 951(a)(1)(A).”

1988—Subsec. (b). Pub. L. 100-647, §1012(p)(15), inserted at end “To the extent provided in regulations, if the fund establishes to the satisfaction of the Secretary that it uses a shorter period than the taxable year to determine shareholders' interests in the earnings of such fund, pro rata shares may be determined by using such shorter period.”

Subsec. (c). Pub. L. 100-647, §1012(p)(23), inserted “, for purposes of this chapter,” after “shall be treated”, and “; except that such distribution shall immediately reduce earnings and profits” after “is not a dividend”.

Subsec. (e)(3). Pub. L. 100-647, §1012(p)(18), added par. (3).

Subsec. (g). Pub. L. 100-647, §1012(p)(32), added subsec. (g).

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 applicable to taxable years of United States persons beginning after Dec. 31, 1997, and to taxable years of foreign corporations ending with or within such taxable years of United States persons, see section 1124 of Pub. L. 105-34, set out as a note under section 532 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103-66 applicable to taxable years of foreign corporations beginning after Sept. 30, 1993, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, see section 13231(e) of Pub. L. 103-66, set out as a note under section 951 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of

the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable to taxable years of foreign corporations beginning after Dec. 31, 1986, see section 1235(h) of Pub. L. 99-514, set out as a note under section 1291 of this title.

§ 1294. Election to extend time for payment of tax on undistributed earnings

(a) Extension allowed by election

(1) In general

At the election of the taxpayer, the time for payment of any undistributed PFIC earnings tax liability of the taxpayer for the taxable year shall be extended to the extent and subject to the limitations provided in this section.

(2) Election not permitted where amounts otherwise includible under section 951

The taxpayer may not make an election under paragraph (1) with respect to the undistributed PFIC earnings tax liability attributable to a qualified electing fund for the taxable year if any amount is includible in the gross income of the taxpayer under section 951 with respect to such fund for such taxable year.

(b) Definitions

For purposes of this section—

(1) Undistributed PFIC earnings tax liability

The term “undistributed PFIC earnings tax liability” means, in the case of any taxpayer, the excess of—

(A) the tax imposed by this chapter for the taxable year, over

(B) the tax which would be imposed by this chapter for such year without regard to the inclusion in gross income under section 1293 of the undistributed earnings of a qualified electing fund.

(2) Undistributed earnings

The term “undistributed earnings” means, with respect to any qualified electing fund, the excess (if any) of—

(A) the amount includible in gross income by reason of section 1293(a) for the taxable year, over

(B) the amount not includible in gross income by reason of section 1293(c) for such taxable year.

(c) Termination of extension

(1) Distributions

(A) In general

If a distribution is not includible in gross income for the taxable year by reason of section 1293(c), then the extension under subsection (a) for payment of the undistributed PFIC earnings tax liability with respect to the earnings to which such distribution is attributable shall expire on the last date prescribed by law (determined without regard to extensions) for filing the return of tax for such taxable year.

(B) Ordering rule

For purposes of subparagraph (A), a distribution shall be treated as made from the

most recently accumulated earnings and profits.

(2) Transfers, etc.

If—

(A) stock in a passive foreign investment company is transferred during the taxable year, or

(B) a passive foreign investment company ceases to be a qualified electing fund,

all extensions under subsection (a) for payment of undistributed PFIC earnings tax liability attributable to such stock (or, in the case of such a cessation, attributable to any stock in such company) which had not expired before the date of such transfer or cessation shall expire on the last date prescribed by law (determined without regard to extensions) for filing the return of tax for the taxable year in which such transfer or cessation occurs. To the extent provided in regulations, the preceding sentence shall not apply in the case of a transfer in a transaction with respect to which gain or loss is not recognized (in whole or in part), and the transferee in such transaction shall succeed to the treatment under this section of the transferor.

(3) Jeopardy

If the Secretary believes that collection of an amount to which an extension under this section relates is in jeopardy, the Secretary shall immediately terminate such extension with respect to such amount, and notice and demand shall be made by him for payment of such amount.

(d) Election

The election under subsection (a) shall be made not later than the time prescribed by law (including extensions) for filing the return of tax imposed by this chapter for the taxable year.

(e) Authority to require bond

Section 6165 shall apply to any extension under this section as though the Secretary were extending the time for payment of the tax.

(f) Treatment of loans to shareholder

For purposes of this section and section 1293, any loan by a qualified electing fund (directly or indirectly) to a shareholder of such fund shall be treated as a distribution to such shareholder.

(g) Cross reference

For provisions providing for interest for the period of the extension under this section, see section 6601.

(Added Pub. L. 99-514, title XII, § 1235(a), Oct. 22, 1986, 100 Stat. 2570; amended Pub. L. 100-647, title I, § 1012(p)(4), (8), (25), (34), Nov. 10, 1988, 102 Stat. 3515, 3517, 3519, 3522; Pub. L. 108-357, title IV, § 413(c)(25), Oct. 22, 2004, 118 Stat. 1509.)

AMENDMENTS

2004—Subsec. (a)(2). Pub. L. 108-357 amended heading and text of par. (2) generally. Prior to amendment, text read as follows: “The taxpayer may not make an election under paragraph (1) with respect to the undistributed PFIC earnings tax liability attributable to a qualified electing fund for the taxable year if—

“(A) any amount is includible in the gross income of the taxpayer under section 551 with respect to such fund for such taxable year, or

“(B) any amount is includible in the gross income of the taxpayer under section 951 with respect to such fund for such taxable year.”

1988—Subsec. (c)(2). Pub. L. 100-647, § 1012(p)(4), (34), substituted “Transfers” for “Dispositions” in heading and “is transferred” for “is disposed of” in subpar. (A), and in closing provisions substituted “such transfer” for “such disposition” in two places and inserted at end “To the extent provided in regulations, the preceding sentence shall not apply in the case of a transfer in a transaction with respect to which gain or loss is not recognized (in whole or in part), and the transferee in such transaction shall succeed to the treatment under this section of the transferor.”

Subsec. (f). Pub. L. 100-647, § 1012(p)(25), added subsec. (f).

Subsec. (g). Pub. L. 100-647, § 1012(p)(8), added subsec. (g).

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-357 applicable to taxable years of foreign corporations beginning after Dec. 31, 2004, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end, see section 413(d)(1) of Pub. L. 108-357, set out as an Effective and Termination Dates of 2004 Amendments note under section 1 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable to taxable years of foreign corporations beginning after Dec. 31, 1986, see section 1235(h) of Pub. L. 99-514, set out as a note under section 1291 of this title.

§ 1295. Qualified electing fund

(a) General rule

For purposes of this part, any passive foreign investment company shall be treated as a qualified electing fund with respect to the taxpayer if—

(1) an election by the taxpayer under subsection (b) applies to such company for the taxable year, and

(2) such company complies with such requirements as the Secretary may prescribe for purposes of—

(A) determining the ordinary earnings and net capital gain of such company, and

(B) otherwise carrying out the purposes of this subpart.

(b) Election

(1) In general

A taxpayer may make an election under this subsection with respect to any passive foreign investment company for any taxable year of the taxpayer. Such an election, once made with respect to any company, shall apply to all subsequent taxable years of the taxpayer with respect to such company unless revoked by the taxpayer with the consent of the Secretary.

(2) When made

An election under this subsection may be made for any taxable year at any time on or before the due date (determined with regard to

extensions) for filing the return of the tax imposed by this chapter for such taxable year. To the extent provided in regulations, such an election may be made later than as required in the preceding sentence where the taxpayer fails to make a timely election because the taxpayer reasonably believed that the company was not a passive foreign investment company.

(Added Pub. L. 99-514, title XII, § 1235(a), Oct. 22, 1986, 100 Stat. 2571; amended Pub. L. 100-647, title I, § 1012(p)(37)(A), title VI, § 6127(a), Nov. 10, 1988, 102 Stat. 3522, 3715.)

AMENDMENTS

1988—Subsec. (a). Pub. L. 100-647, § 6127(a), amended subsec. (a) generally. Prior to amendment, subsec. (a) read as follows: “For purposes of this part, the term ‘qualified electing fund’ means any passive foreign investment company if—

“(1) an election under subsection (b) applies to such company for the taxable year, and

“(2) such company complies for such taxable year with such requirements as the Secretary may prescribe for purposes of—

“(A) determining the ordinary earnings and net capital gain of such company for the taxable year,

“(B) ascertaining the ownership of its outstanding stock, and

“(C) otherwise carrying out the purposes of this subpart.”

Subsec. (b). Pub. L. 100-647, § 6127(a), amended subsec. (b) generally. Prior to amendment, subsec. (b) read as follows:

“(1) IN GENERAL.—A passive foreign investment company may make an election under this subsection for any taxable year. Such an election, once made, shall apply to all subsequent taxable years of such company for which such company is a passive foreign investment company unless revoked with the consent of the Secretary.

“(2) WHEN MADE.—An election under this subsection may be made for any taxable year at any time before the 15th day of the 3rd month of the following taxable year. To the extent provided in regulations, such an election may be made later than as required by the preceding sentence in cases where the company failed to make a timely election because it reasonably believed it was not a passive foreign investment company.”

Pub. L. 100-647, § 1012(p)(37)(A), inserted sentence at end of par. (2) permitting a later election when a company reasonably believed it was not a passive foreign investment company.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by section 1012(p)(37)(A) of Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

Section 6127(c) of Pub. L. 100-647 provided that:

“(1) IN GENERAL.—The amendments made by this section [amending this section and section 1291 of this title] shall take effect as if included in the amendments made by section 1235 of the Reform Act [Pub. L. 99-514].

“(2) TIME FOR MAKING ELECTION.—The period during which an election under section 1295(b) of the 1986 Code may be made shall in no event expire before the date 60 days after the date of the enactment of this Act [Nov. 10, 1988].”

EFFECTIVE DATE

Section applicable to taxable years of foreign corporations beginning after Dec. 31, 1986, see section 1235(h) of Pub. L. 99-514, set out as a note under section 1291 of this title.

EXPIRATION OF SUBSECTION (b) ELECTION PERIOD

Section 1012(p)(37)(B) of Pub. L. 100-647 provided that: “The period during which an election under section 1295(b) of the 1986 Code may be made shall in no event expire before the date 60 days after the date of enactment of this Act [Nov. 10, 1988].”

SUBPART C—ELECTION OF MARK TO MARKET FOR MARKETABLE STOCK

Sec.
1296. Election of mark to market for marketable stock.

AMENDMENTS

1997—Pub. L. 105-34, title XI, §1122(a), Aug. 5, 1997, 111 Stat. 972, added subpart C and item 1296. Former subpart C redesignated D.

PRIOR PROVISIONS

A prior subpart C, consisting of sections 1296 and 1297 of this title, was redesignated subpart D consisting of sections 1297 and 1298.

§ 1296. Election of mark to market for marketable stock**(a) General rule**

In the case of marketable stock in a passive foreign investment company which is owned (or treated under subsection (g) as owned) by a United States person at the close of any taxable year of such person, at the election of such person—

(1) If the fair market value of such stock as of the close of such taxable year exceeds its adjusted basis, such United States person shall include in gross income for such taxable year an amount equal to the amount of such excess.

(2) If the adjusted basis of such stock exceeds the fair market value of such stock as of the close of such taxable year, such United States person shall be allowed a deduction for such taxable year equal to the lesser of—

(A) the amount of such excess, or

(B) the unreversed inclusions with respect to such stock.

(b) Basis adjustments**(1) In general**

The adjusted basis of stock in a passive foreign investment company—

(A) shall be increased by the amount included in the gross income of the United States person under subsection (a)(1) with respect to such stock, and

(B) shall be decreased by the amount allowed as a deduction to the United States person under subsection (a)(2) with respect to such stock.

(2) Special rule for stock constructively owned

In the case of stock in a passive foreign investment company which the United States person is treated as owning under subsection (g)—

(A) the adjustments under paragraph (1) shall apply to such stock in the hands of the person actually holding such stock but only for purposes of determining the subsequent treatment under this chapter of the United States person with respect to such stock, and

(B) similar adjustments shall be made to the adjusted basis of the property by reason of which the United States person is treated as owning such stock.

(c) Character and source rules**(1) Ordinary treatment****(A) Gain**

Any amount included in gross income under subsection (a)(1), and any gain on the sale or other disposition of marketable stock in a passive foreign investment company (with respect to which an election under this section is in effect), shall be treated as ordinary income.

(B) Loss

Any—

(i) amount allowed as a deduction under subsection (a)(2), and

(ii) loss on the sale or other disposition of marketable stock in a passive foreign investment company (with respect to which an election under this section is in effect) to the extent that the amount of such loss does not exceed the unreversed inclusions with respect to such stock,

shall be treated as an ordinary loss. The amount so treated shall be treated as a deduction allowable in computing adjusted gross income.

(2) Source

The source of any amount included in gross income under subsection (a)(1) (or allowed as a deduction under subsection (a)(2)) shall be determined in the same manner as if such amount were gain or loss (as the case may be) from the sale of stock in the passive foreign investment company.

(d) Unreversed inclusions

For purposes of this section, the term “unreversed inclusions” means, with respect to any stock in a passive foreign investment company, the excess (if any) of—

(1) the amount included in gross income of the taxpayer under subsection (a)(1) with respect to such stock for prior taxable years, over

(2) the amount allowed as a deduction under subsection (a)(2) with respect to such stock for prior taxable years.

The amount referred to in paragraph (1) shall include any amount which would have been included in gross income under subsection (a)(1) with respect to such stock for any prior taxable year but for section 1291. In the case of a regulated investment company which elected to mark to market the stock held by such company as of the last day of the taxable year preceding such company's first taxable year for which such company elects the application of this section, the amount referred to in paragraph (1) shall include amounts included in gross income under such mark to market with respect to such stock for prior taxable years.

(e) Marketable stock

For purposes of this section—

(1) In general

The term “marketable stock” means—

(A) any stock which is regularly traded on—

(i) a national securities exchange which is registered with the Securities and Exchange Commission or the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934, or

(ii) any exchange or other market which the Secretary determines has rules adequate to carry out the purposes of this part,

(B) to the extent provided in regulations, stock in any foreign corporation which is comparable to a regulated investment company and which offers for sale or has outstanding any stock of which it is the issuer and which is redeemable at its net asset value, and

(C) to the extent provided in regulations, any option on stock described in subparagraph (A) or (B).

(2) Special rule for regulated investment companies

In the case of any regulated investment company which is offering for sale or has outstanding any stock of which it is the issuer and which is redeemable at its net asset value, all stock in a passive foreign investment company which it owns directly or indirectly shall be treated as marketable stock for purposes of this section. Except as provided in regulations, similar treatment as marketable stock shall apply in the case of any other regulated investment company which publishes net asset valuations at least annually.

(f) Treatment of controlled foreign corporations which are shareholders in passive foreign investment companies

In the case of a foreign corporation which is a controlled foreign corporation and which owns (or is treated under subsection (g) as owning) stock in a passive foreign investment company—

(1) this section (other than subsection (c)(2)) shall apply to such foreign corporation in the same manner as if such corporation were a United States person, and

(2) for purposes of subpart F of part III of subchapter N—

(A) any amount included in gross income under subsection (a)(1) shall be treated as foreign personal holding company income described in section 954(c)(1)(A), and

(B) any amount allowed as a deduction under subsection (a)(2) shall be treated as a deduction allocable to foreign personal holding company income so described.

(g) Stock owned through certain foreign entities

Except as provided in regulations—

(1) In general

For purposes of this section, stock owned, directly or indirectly, by or for a foreign partnership or foreign trust or foreign estate shall be considered as being owned proportionately by its partners or beneficiaries. Stock considered to be owned by a person by reason of the application of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person.

(2) Treatment of certain dispositions

In any case in which a United States person is treated as owning stock in a passive foreign investment company by reason of paragraph (1)—

(A) any disposition by the United States person or by any other person which results in the United States person being treated as no longer owning such stock, and

(B) any disposition by the person owning such stock,

shall be treated as a disposition by the United States person of the stock in the passive foreign investment company.

(h) Coordination with section 851(b)

For purposes of section 851(b)(2), any amount included in gross income under subsection (a) shall be treated as a dividend.

(i) Stock acquired from a decedent

In the case of stock of a passive foreign investment company which is acquired by bequest, devise, or inheritance (or by the decedent's estate) and with respect to which an election under this section was in effect as of the date of the decedent's death, notwithstanding section 1014, the basis of such stock in the hands of the person so acquiring it shall be the adjusted basis of such stock in the hands of the decedent immediately before his death (or, if lesser, the basis which would have been determined under section 1014 without regard to this subsection).

(j) Coordination with section 1291 for first year of election

(1) Taxpayers other than regulated investment companies

(A) In general

If the taxpayer elects the application of this section with respect to any marketable stock in a corporation after the beginning of the taxpayer's holding period in such stock, and if the requirements of subparagraph (B) are not satisfied, section 1291 shall apply to—

(i) any distributions with respect to, or disposition of, such stock in the first taxable year of the taxpayer for which such election is made, and

(ii) any amount which, but for section 1291, would have been included in gross income under subsection (a) with respect to such stock for such taxable year in the same manner as if such amount were gain on the disposition of such stock.

(B) Requirements

The requirements of this subparagraph are met if, with respect to each of such corporation's taxable years for which such corporation was a passive foreign investment company and which begin after December 31, 1986, and included any portion of the taxpayer's holding period in such stock, such corporation was treated as a qualified electing fund under this part with respect to the taxpayer.

(2) Special rules for regulated investment companies

(A) In general

If a regulated investment company elects the application of this section with respect to any marketable stock in a corporation after the beginning of the taxpayer's holding period in such stock, then, with respect to such company's first taxable year for which such company elects the application of this section with respect to such stock—

(i) section 1291 shall not apply to such stock with respect to any distribution or disposition during, or amount included in gross income under this section for, such first taxable year, but

(ii) such regulated investment company's tax under this chapter for such first taxable year shall be increased by the aggregate amount of interest which would have been determined under section 1291(c)(3) if section 1291 were applied without regard to this subparagraph.

Clause (ii) shall not apply if for the preceding taxable year the company elected to mark to market the stock held by such company as of the last day of such preceding taxable year.

(B) Disallowance of deduction

No deduction shall be allowed to any regulated investment company for the increase in tax under subparagraph (A)(ii).

(k) Election

This section shall apply to marketable stock in a passive foreign investment company which is held by a United States person only if such person elects to apply this section with respect to such stock. Such an election shall apply to the taxable year for which made and all subsequent taxable years unless—

- (1) such stock ceases to be marketable stock, or
- (2) the Secretary consents to the revocation of such election.

(l) Transition rule for individuals becoming subject to United States tax

If any individual becomes a United States person in a taxable year beginning after December 31, 1997, solely for purposes of this section, the adjusted basis (before adjustments under subsection (b)) of any marketable stock in a passive foreign investment company owned by such individual on the first day of such taxable year shall be treated as being the greater of its fair market value on such first day or its adjusted basis on such first day.

(Added Pub. L. 105-34, title XI, §1122(a), Aug. 5, 1997, 111 Stat. 972; amended Pub. L. 105-206, title VI, §6011(c)(3), July 22, 1998, 112 Stat. 818; Pub. L. 107-16, title V, §542(e)(5)(C), June 7, 2001, 115 Stat. 85; Pub. L. 108-311, title IV, §408(a)(19), Oct. 4, 2004, 118 Stat. 1192; Pub. L. 111-312, title III, §301(a), Dec. 17, 2010, 124 Stat. 3300.)

AMENDMENT OF SECTION

For termination of amendment by section 304 of Pub. L. 111-312, see Effective and Termination Dates of 2010 Amendment note below.

For termination of amendment by section 901 of Pub. L. 107-16, see Effective and Termination Dates of 2001 Amendment note below.

REFERENCES IN TEXT

Section 11A of the Securities and Exchange Act of 1934, referred to in subsec. (e)(1)(A)(i), is classified to section 78k-1 of Title 15, Commerce and Trade.

PRIOR PROVISIONS

A prior section 1296 was renumbered section 1297 of this title.

AMENDMENTS

2010—Subsec. (i). Pub. L. 111-312, §§301(a), 304, temporarily amended subsec. (i) to read as if amendment by Pub. L. 107-16, §542(e)(5)(C), had never been enacted. See 2001 Amendment note and Effective and Termination Dates of 2010 Amendment note below.

2004—Subsec. (h). Pub. L. 108-311 substituted “section 851(b)(2)” for “paragraphs (2) and (3) of section 851(b)”.

2001—Subsec. (i). Pub. L. 107-16, §§542(e)(5)(C), 901, temporarily struck out subsec. (i). Text read as follows: “In the case of stock of a passive foreign investment company which is acquired by bequest, devise, or inheritance (or by the decedent's estate) and with respect to which an election under this section was in effect as of the date of the decedent's death, notwithstanding section 1014, the basis of such stock in the hands of the person so acquiring it shall be the adjusted basis of such stock in the hands of the decedent immediately before his death (or, if lesser, the basis which would have been determined under section 1014 without regard to this subsection).” See Effective and Termination Dates of 2001 Amendment note below.

1998—Subsec. (d). Pub. L. 105-206 inserted at end “In the case of a regulated investment company which elected to mark to market the stock held by such company as of the last day of the taxable year preceding such company's first taxable year for which such company elects the application of this section, the amount referred to in paragraph (1) shall include amounts included in gross income under such mark to market with respect to such stock for prior taxable years.”

EFFECTIVE AND TERMINATION DATES OF 2010 AMENDMENT

Amendment by Pub. L. 111-312 applicable to estates of decedents dying, and transfers made after Dec. 31, 2009, except as otherwise provided, see section 301(e) of Pub. L. 111-312, set out as a note under section 121 of this title.

Section 901 of Pub. L. 107-16 applicable to amendments by section 301(a) of Pub. L. 111-312, see section 304 of Pub. L. 111-312, set out as a note under section 121 of this title.

EFFECTIVE AND TERMINATION DATES OF 2001 AMENDMENT

Amendment by Pub. L. 107-16 applicable to estates of decedents dying after Dec. 31, 2009, see section 542(f)(1) of Pub. L. 107-16, set out as a note under section 121 of this title.

Amendment by Pub. L. 107-16 inapplicable to estates of decedents dying, gifts made, or generation skipping transfers, after Dec. 31, 2012, and the Internal Revenue Code of 1986 to be applied and administered to such estates, gifts, and transfers as if such amendment had never been enacted, see section 901 of Pub. L. 107-16, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1998 AMENDMENT

Amendment by Pub. L. 105-206 effective, except as otherwise provided, as if included in the provisions of the Taxpayer Relief Act of 1997, Pub. L. 105-34, to which such amendment relates, see section 6024 of Pub. L. 105-206, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable to taxable years of United States persons beginning after Dec. 31, 1997, and to taxable

years of foreign corporations ending with or within such taxable years of United States persons, see section 1124 of Pub. L. 105-34, set out as an Effective Date of 1997 Amendment note under section 532 of this title.

SUBPART D—GENERAL PROVISIONS

Sec.	
1297.	Passive foreign investment company.
1298.	Special rules.

AMENDMENTS

1997—Pub. L. 105-34, title XI, §1122(a), (d)(5), Aug. 5, 1997, 111 Stat. 972, 977, redesignated subpart C of this part as this subpart and amended table of sections generally, renumbering items 1296 and 1297 as 1297 and 1298, respectively.

§ 1297. Passive foreign investment company

(a) In general

For purposes of this part, except as otherwise provided in this subpart, the term “passive foreign investment company” means any foreign corporation if—

- (1) 75 percent or more of the gross income of such corporation for the taxable year is passive income, or
- (2) the average percentage of assets (as determined in accordance with subsection (e)) held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent.

(b) Passive income

For purposes of this section—

(1) In general

Except as provided in paragraph (2), the term “passive income” means any income which is of a kind which would be foreign personal holding company income as defined in section 954(c).

(2) Exceptions

Except as provided in regulations, the term “passive income” does not include any income—

(A) derived in the active conduct of a banking business by an institution licensed to do business as a bank in the United States (or, to the extent provided in regulations, by any other corporation),

(B) derived in the active conduct of an insurance business by a corporation which is predominantly engaged in an insurance business and which would be subject to tax under subchapter L if it were a domestic corporation,

(C) which is interest, a dividend, or a rent or royalty, which is received or accrued from a related person (within the meaning of section 954(d)(3)) to the extent such amount is properly allocable (under regulations prescribed by the Secretary) to income of such related person which is not passive income, or

(D) which is export trade income of an export trade corporation (as defined in section 971).

For purposes of subparagraph (C), the term “related person” has the meaning given such term by section 954(d)(3) determined by sub-

stituting “foreign corporation” for “controlled foreign corporation” each place it appears in section 954(d)(3).

(c) Look-thru in the case of 25-percent owned corporations

If a foreign corporation owns (directly or indirectly) at least 25 percent (by value) of the stock of another corporation, for purposes of determining whether such foreign corporation is a passive foreign investment company, such foreign corporation shall be treated as if it—

- (1) held its proportionate share of the assets of such other corporation, and
- (2) received directly its proportionate share of the income of such other corporation.

(d) Exception for United States shareholders of controlled foreign corporations

(1) In general

For purposes of this part, a corporation shall not be treated with respect to a shareholder as a passive foreign investment company during the qualified portion of such shareholder's holding period with respect to stock in such corporation.

(2) Qualified portion

For purposes of this subsection, the term “qualified portion” means the portion of the shareholder's holding period—

(A) which is after December 31, 1997, and

(B) during which the shareholder is a United States shareholder (as defined in section 951(b)) of the corporation and the corporation is a controlled foreign corporation.

(3) New holding period if qualified portion ends

(A) In general

Except as provided in subparagraph (B), if the qualified portion of a shareholder's holding period with respect to any stock ends after December 31, 1997, solely for purposes of this part, the shareholder's holding period with respect to such stock shall be treated as beginning as of the first day following such period.

(B) Exception

Subparagraph (A) shall not apply if such stock was, with respect to such shareholder, stock in a passive foreign investment company at any time before the qualified portion of the shareholder's holding period with respect to such stock and no election under section 1298(b)(1) is made.

(4) Treatment of holders of options

Paragraph (1) shall not apply to stock treated as owned by a person by reason of section 1298(a)(4) (relating to the treatment of a person that has an option to acquire stock as owning such stock) unless such person establishes that such stock is owned (within the meaning of section 958(a)) by a United States shareholder (as defined in section 951(b)) who is not exempt from tax under this chapter.

(e) Methods for measuring assets

(1) Determination using value

The determination under subsection (a)(2) shall be made on the basis of the value of the assets of a foreign corporation if—

(A) such corporation is a publicly traded corporation for the taxable year, or

(B) paragraph (2) does not apply to such corporation for the taxable year.

(2) Determination using adjusted bases

The determination under subsection (a)(2) shall be based on the adjusted bases (as determined for the purposes of computing earnings and profits) of the assets of a foreign corporation if such corporation is not described in paragraph (1)(A) and such corporation—

(A) is a controlled foreign corporation, or

(B) elects the application of this paragraph.

An election under subparagraph (B), once made, may be revoked only with the consent of the Secretary.

(3) Publicly traded corporation

For purposes of this subsection, a foreign corporation shall be treated as a publicly traded corporation if the stock in the corporation is regularly traded on—

(A) a national securities exchange which is registered with the Securities and Exchange Commission or the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934, or

(B) any exchange or other market which the Secretary determines has rules adequate to carry out the purposes of this subsection.

(Added Pub. L. 99-514, title XII, § 1235(a), Oct. 22, 1986, 100 Stat. 2572, § 1296; amended Pub. L. 100-647, title I, §§ 1012(p)(2), (5), (16), (26), (27), 1018(u)(40), Nov. 10, 1988, 102 Stat. 3515, 3518-3520, 3592; Pub. L. 103-66, title XIII, § 13231(d)(1), (3), Aug. 10, 1993, 107 Stat. 499; Pub. L. 104-188, title I, § 1704(r)(1), Aug. 20, 1996, 110 Stat. 1887; renumbered § 1297 and amended Pub. L. 105-34, title XI, §§ 1121, 1122(a), (d)(4), 1123, Aug. 5, 1997, 111 Stat. 971, 972, 977; Pub. L. 105-206, title VI, § 6011(b)(1), (d), July 22, 1998, 112 Stat. 817, 818; Pub. L. 110-172, § 11(a)(24)(A), (g)(18), Dec. 29, 2007, 121 Stat. 2486, 2491.)

REFERENCES IN TEXT

Section 11A of the Securities and Exchange Act of 1934, referred to in subsec. (e)(3)(A), is classified to section 78k-1 of Title 15, Commerce and Trade.

PRIOR PROVISIONS

A prior section 1297 was renumbered section 1298 of this title.

AMENDMENTS

2007—Subsec. (b)(2)(D). Pub. L. 110-172, § 11(g)(18), which directed amendment of subpar. (D) by striking out “foreign trade income of a FSC or”, was executed by striking out “foreign trade income of an FSC or” before “export trade income” to reflect the probable intent of Congress.

Subsecs. (d) to (f). Pub. L. 110-172, § 11(a)(24)(A), redesignated subsecs. (e) and (f) as (d) and (e), respectively, and struck out heading and text of former subsec. (d). Text read as follows: “For purposes of this part, the term ‘passive foreign investment company’ does not include any foreign investment company to which section 1247 applies.”

1998—Subsec. (e). Pub. L. 105-206, § 6011(d), redesignated subsec. (e), relating to methods for measuring assets, as (f).

Subsec. (e)(4). Pub. L. 105-206, § 6011(b)(1), added par. (4).

Subsec. (f). Pub. L. 105-206, § 6011(d), redesignated subsec. (e), relating to methods for measuring assets, as (f).

1997—Pub. L. 105-34, § 1122(a), renumbered section 1296 of this title as this section.

Subsec. (a). Pub. L. 105-34, § 1123(b)(2), struck out concluding provisions which read as follows: “In the case of a controlled foreign corporation (or any other foreign corporation if such corporation so elects), the determination under paragraph (2) shall be based on the adjusted bases (as determined for purposes of computing earnings and profits) of its assets in lieu of their value. Such an election, once made, may be revoked only with the consent of the Secretary.”

Subsec. (a)(2). Pub. L. 105-34, § 1123(b)(1), substituted “(as determined in accordance with subsection (e))” for “(by value)”.

Subsec. (b)(3). Pub. L. 105-34, § 1122(d)(4), struck out par. (3) which consisted of subpars. (A) to (C) relating to treatment of certain dealers in securities.

Subsec. (e). Pub. L. 105-34, § 1123(a), added subsec. (e) relating to methods for measuring assets.

Pub. L. 105-34, § 1121, added subsec. (e) relating to exception for United States shareholders of controlled foreign corporations.

1996—Subsec. (b)(2)(D). Pub. L. 104-188 added subpar. (D).

1993—Subsec. (a). Pub. L. 103-66, § 13231(d)(1), substituted in closing provisions “In the case of a controlled foreign corporation (or any other foreign corporation if such corporation so elects), the determination under paragraph (2) shall be based on the adjusted bases (as determined for purposes of computing earnings and profits) of its assets in lieu of their value. Such an election, once made, may be revoked only with the consent of the Secretary.” for “A foreign corporation may elect to have the determination under paragraph (2) based on the adjusted bases of its assets in lieu of their value. Such an election, once made, may be revoked only with the consent of the Secretary.”

Subsec. (b)(3). Pub. L. 103-66, § 13231(d)(3), added par. (3).

1988—Subsec. (a). Pub. L. 100-647, § 1018(u)(40), inserted a comma after “subpart”.

Pub. L. 100-647, § 1012(p)(27), inserted at end “A foreign corporation may elect to have the determination under paragraph (2) based on the adjusted bases of its assets in lieu of their value. Such an election, once made, may be revoked only with the consent of the Secretary.”

Subsec. (b)(1). Pub. L. 100-647, § 1012(p)(5), amended par. (1) generally. Prior to amendment, par. (1) read as follows: “Except as provided in paragraph (2), the term ‘passive income’ has the meaning given such term by section 904(d)(2)(A) without regard to the exceptions contained in clause (iii) thereof.”

Subsec. (b)(2). Pub. L. 100-647, § 1012(p)(26), substituted “Exceptions” for “Exception for certain banks and insurance companies” in heading, and inserted sentence at end defining “related person”.

Subsec. (b)(2)(B). Pub. L. 100-647, § 1012(p)(16), inserted “is predominantly engaged in an insurance business and which” after “a corporation which”.

Subsec. (b)(2)(C). Pub. L. 100-647, § 1012(p)(26)(A), added subpar. (C).

Subsec. (c). Pub. L. 100-647, § 1012(p)(2), inserted “(directly or indirectly)” after “foreign corporation owns”.

EFFECTIVE DATE OF 1998 AMENDMENT

Amendment by Pub. L. 105-206 effective, except as otherwise provided, as if included in the provisions of the Taxpayer Relief Act of 1997, Pub. L. 105-34, to which such amendment relates, see section 6024 of Pub. L. 105-206, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 applicable to taxable years of United States persons beginning after Dec. 31, 1997, and to taxable years of foreign corporations end-

ing with or within such taxable years of United States persons, see section 1124 of Pub. L. 105-34, set out as a note under section 532 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Section 1704(r)(2) of Pub. L. 104-188 provided that: “The amendments made by paragraph (1) [amending this section] shall take effect as if included in the amendments made by section 1235 of the Tax Reform Act of 1986 [Pub. L. 99-514].”

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103-66 applicable to taxable years of foreign corporations beginning after Sept. 30, 1993, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, see section 13231(e) of Pub. L. 103-66, set out as a note under section 951 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable to taxable years of foreign corporations beginning after Dec. 31, 1986, see section 1235(h) of Pub. L. 99-514, set out as a note under section 1291 of this title.

§ 1298. Special rules

(a) Attribution of ownership

For purposes of this part—

(1) Attribution to United States persons

This subsection—

(A) shall apply to the extent that the effect is to treat stock of a passive foreign investment company as owned by a United States person, and

(B) except to the extent provided in regulations, shall not apply to treat stock owned (or treated as owned under this subsection) by a United States person as owned by any other person.

(2) Corporations

(A) In general

If 50 percent or more in value of the stock of a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned directly or indirectly by or for such corporation in that proportion which the value of the stock which such person so owns bears to the value of all stock in the corporation.

(B) 50-percent limitation not to apply to PFIC

For purposes of determining whether a shareholder of a passive foreign investment company is treated as owning stock owned directly or indirectly by or for such company, subparagraph (A) shall be applied without regard to the 50-percent limitation contained therein. Section 1297(d) shall not apply in determining whether a corporation is a passive foreign investment company for purposes of this subparagraph.

(3) Partnerships, etc.

Stock owned, directly or indirectly, by or for a partnership, estate, or trust shall be con-

sidered as being owned proportionately by its partners or beneficiaries.

(4) Options

To the extent provided in regulations, if any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(5) Successive application

Stock considered to be owned by a person by reason of the application of paragraph (2), (3), or (4) shall, for purposes of applying such paragraphs, be considered as actually owned by such person.

(b) Other special rules

For purposes of this part—

(1) Time for determination

Stock held by a taxpayer shall be treated as stock in a passive foreign investment company if, at any time during the holding period of the taxpayer with respect to such stock, such corporation (or any predecessor) was a passive foreign investment company which was not a qualified electing fund. The preceding sentence shall not apply if the taxpayer elects to recognize gain (as of the last day of the last taxable year for which the company was a passive foreign investment company (determined without regard to the preceding sentence)) under rules similar to the rules of section 1291(d)(2).

(2) Certain corporations not treated as PFIC's during start-up year

A corporation shall not be treated as a passive foreign investment company for the first taxable year such corporation has gross income (hereinafter in this paragraph referred to as the “start-up year”) if—

(A) no predecessor of such corporation was a passive foreign investment company,

(B) it is established to the satisfaction of the Secretary that such corporation will not be a passive foreign investment company for either of the 1st 2 taxable years following the start-up year, and

(C) such corporation is not a passive foreign investment company for either of the 1st 2 taxable years following the start-up year.

(3) Certain corporations changing businesses

A corporation shall not be treated as a passive foreign investment company for any taxable year if—

(A) neither such corporation (nor any predecessor) was a passive foreign investment company for any prior taxable year,

(B) it is established to the satisfaction of the Secretary that—

(i) substantially all of the passive income of the corporation for the taxable year is attributable to proceeds from the disposition of 1 or more active trades or businesses, and

(ii) such corporation will not be a passive foreign investment company for ei-

ther of the 1st 2 taxable years following such taxable year, and

(C) such corporation is not a passive foreign investment company for either of such 2 taxable years.

(4) Separate interests treated as separate corporations

Under regulations prescribed by the Secretary, where necessary to carry out the purposes of this part, separate classes of stock (or other interests) in a corporation shall be treated as interests in separate corporations.

(5) Application of part where stock held by other entity

(A) In general

Under regulations, in any case in which a United States person is treated as owning stock in a passive foreign investment company by reason of subsection (a)—

(i) any disposition by the United States person or the person owning such stock which results in the United States person being treated as no longer owning such stock, or

(ii) any distribution of property in respect of such stock to the person holding such stock,

shall be treated as a disposition by, or distribution to, the United States person with respect to the stock in the passive foreign investment company.

(B) Amount treated in same manner as previously taxed income

Rules similar to the rules of section 959(b) shall apply to any amount described in subparagraph (A) and to any amount included in gross income under section 1293(a) (or which would have been so included but for section 951(f))¹ in respect of stock which the taxpayer is treated as owning under subsection (a).

(6) Dispositions

Except as provided in regulations, if a taxpayer uses any stock in a passive foreign investment company as security for a loan, the taxpayer shall be treated as having disposed of such stock.

(7) Treatment of certain foreign corporations owning stock in 25-percent owned domestic corporation

(A) In general

If—

(i) a foreign corporation is subject to the tax imposed by section 531 (or waives any benefit under any treaty which would otherwise prevent the imposition of such tax), and

(ii) such foreign corporation owns at least 25 percent (by value) of the stock of a domestic corporation,

for purposes of determining whether such foreign corporation is a passive foreign investment company, any qualified stock held by such domestic corporation shall be treat-

ed as an asset which does not produce passive income (and is not held for the production of passive income) and any amount included in gross income with respect to such stock shall not be treated as passive income.

(B) Qualified stock

For purposes of subparagraph (A), the term “qualified stock” means any stock in a C corporation which is a domestic corporation and which is not a regulated investment company or real estate investment trust.

(8) Treatment of certain subpart F inclusions

Any amount included in gross income under section 951(a)(1)(B) shall be treated as a distribution received with respect to the stock.

(c) Treatment of stock held by pooled income fund

If stock in a passive foreign investment company is owned (or treated as owned under subsection (a)) by a pooled income fund (as defined in section 642(c)(5)) and no portion of any gain from a disposition of such stock may be allocated to income under the terms of the governing instrument of such fund—

(1) section 1291 shall not apply to any gain on a disposition of such stock by such fund if (without regard to section 1291) a deduction would be allowable with respect to such gain under section 642(c)(3),

(2) section 1293 shall not apply with respect to such stock, and

(3) in determining whether section 1291 applies to any distribution in respect of such stock, subsection (d) of section 1291 shall not apply.

(d) Treatment of certain leased property

For purposes of this part—

(1) In general

Any tangible personal property with respect to which a foreign corporation is the lessee under a lease with a term of at least 12 months shall be treated as an asset actually held by such corporation.

(2) Amount taken into account

(A) In general

The amount taken into account under section 1296(a)(2)¹ with respect to any asset to which paragraph (1) applies shall be the unamortized portion (as determined under regulations prescribed by the Secretary) of the present value of the payments under the lease for the use of such property.

(B) Present value

For purposes of subparagraph (A), the present value of payments described in subparagraph (A) shall be determined in the manner provided in regulations prescribed by the Secretary—

(i) as of the beginning of the lease term, and

(ii) except as provided in such regulations, by using a discount rate equal to the applicable Federal rate determined under section 1274(d)—

(I) by substituting the lease term for the term of the debt instrument, and

¹ See References in Text notes below.

(II) without regard to paragraph (2) or (3) thereof.

(3) Exceptions

This subsection shall not apply in any case where—

(A) the lessor is a related person (as defined in section 954(d)(3)) with respect to the foreign corporation, or

(B) a principal purpose of leasing the property was to avoid the provisions of this part.

(e) Special rules for certain intangibles

For purposes of this part—

(1) Research expenditures

The adjusted basis of the total assets of a controlled foreign corporation shall be increased by the research or experimental expenditures (within the meaning of section 174) paid or incurred by such foreign corporation during the taxable year and the preceding 2 taxable years. Any expenditure otherwise taken into account under the preceding sentence shall be reduced by the amount of any reimbursement received by the controlled foreign corporation with respect to such expenditure.

(2) Certain licensed intangibles

(A) In general

In the case of any intangible property (as defined in section 936(h)(3)(B)) with respect to which a controlled foreign corporation is a licensee and which is used by such foreign corporation in the active conduct of a trade or business, the adjusted basis of the total assets of such foreign corporation shall be increased by an amount equal to 300 percent of the payments made during the taxable year by such foreign corporation for the use of such intangible property.

(B) Exceptions

Subparagraph (A) shall not apply to—

(i) any payments to a foreign person if such foreign person is a related person (as defined in section 954(d)(3)) with respect to the controlled foreign corporation, and

(ii) any payments under a license if a principal purpose of entering into such license was to avoid the provisions² of this part.

(3) Controlled foreign corporation

For purposes of this subsection, the term “controlled foreign corporation” has the meaning given such term by section 957(a).

(f) Reporting requirement

Except as otherwise provided by the Secretary, each United States person who is a shareholder of a passive foreign investment company shall file an annual report containing such information as the Secretary may require.

(g) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this part.

(Added Pub. L. 99-514, title XII, § 1235(a), Oct. 22, 1986, 100 Stat. 2573, § 1297; amended Pub. L.

100-647, title I, § 1012(p)(10), (17), (20), (22), (24), (35), (36), Nov. 10, 1988, 102 Stat. 3517-3519, 3522; Pub. L. 101-239, title VII, § 7811(i)(4), Dec. 19, 1989, 103 Stat. 2410; Pub. L. 103-66, title XIII, § 13231(d)(2), (4), Aug. 10, 1993, 107 Stat. 499; Pub. L. 104-188, title I, §§ 1501(b)(10), (11), 1703(i)(5), (6), Aug. 20, 1996, 110 Stat. 1826, 1876; renumbered § 1298 and amended Pub. L. 105-34, title XI, § 1122(a), (e), Aug. 5, 1997, 111 Stat. 972, 977; Pub. L. 105-206, title VI, § 6011(b)(2), July 22, 1998, 112 Stat. 818; Pub. L. 110-172, § 11(a)(24)(C), (f)(2), Dec. 29, 2007, 121 Stat. 2487, 2489; Pub. L. 111-147, title V, § 521(a), Mar. 18, 2010, 124 Stat. 112.)

REFERENCES IN TEXT

Section 951(f), referred to in subsec. (b)(5)(B), was redesignated section 951(d) by Pub. L. 108-357, title IV, § 413(c)(16), Oct. 22, 2004, 118 Stat. 1508, and subsequently was redesignated section 951(c) by Pub. L. 110-172, § 11(g)(13), Dec. 29, 2007, 121 Stat. 2490.

Section 1296, referred to in subsec. (d)(2)(A), was renumbered section 1297 and a new section 1296 was added by Pub. L. 105-34, title XI, § 1122(a), Aug. 5, 1997, 111 Stat. 972.

AMENDMENTS

2010—Subsecs. (f), (g). Pub. L. 111-147 added subsec. (f) and redesignated former subsec. (f) as (g).

2007—Subsec. (a)(2)(B). Pub. L. 110-172, § 11(a)(24)(C), substituted “Section 1297(d)” for “Section 1297(e)”.

Subsec. (b)(7) to (9). Pub. L. 110-172, § 11(f)(2), redesignated pars. (8) and (9) as (7) and (8), respectively, and struck out former par. (7) which read as follows: “Section 1246 shall not apply to earnings and profits of any company for any taxable year beginning after December 31, 1986, if such company is a passive foreign investment company for such taxable year.”

1998—Subsec. (a)(2)(B). Pub. L. 105-206 inserted at end “Section 1297(e) shall not apply in determining whether a corporation is a passive foreign investment company for purposes of this subparagraph.”

1997—Pub. L. 105-34, § 1122(a), renumbered section 1297 of this title as this section.

Subsec. (b)(1). Pub. L. 105-34, § 1122(e), inserted “(determined without regard to the preceding sentence)” after “investment company” in last sentence.

1996—Subsec. (b)(9). Pub. L. 104-188, § 1501(b)(10), substituted “section 951(a)(1)(B)” for “subparagraph (B) or (C) of section 951(a)(1)”.

Subsec. (d)(2). Pub. L. 104-188, § 1703(i)(5)(B), in heading substituted “Amount taken into account” for “Determination of adjusted basis”.

Subsec. (d)(2)(A). Pub. L. 104-188, § 1703(i)(5)(A), substituted “The amount taken into account under section 1296(a)(2) with respect to any asset” for “The adjusted basis of any asset”.

Subsec. (d)(3)(B). Pub. L. 104-188, § 1501(b)(11), struck out “or section 956A” after “this part”.

Subsec. (e). Pub. L. 104-188, § 1703(i)(6), inserted “For purposes of this part—” after heading.

Subsec. (e)(2)(B)(ii). Pub. L. 104-188, § 1501(b)(11), struck out “or section 956A” after “this part”.

1993—Subsec. (b)(9). Pub. L. 103-66, § 13231(d)(2), added par. (9).

Subsecs. (d) to (f). Pub. L. 103-66, § 13231(d)(4), added subsecs. (d) and (e) and redesignated former subsec. (d) as (f).

1989—Subsec. (b)(5). Pub. L. 101-239, § 7811(i)(4)(A), substituted “where stock held” for “where held” in heading.

Subsec. (b)(5)(A). Pub. L. 101-239, § 7811(i)(4)(C), substituted “treated as a disposition by, or distribution to” for “treated as a disposition to” in concluding provisions.

Subsec. (b)(5)(A)(ii). Pub. L. 101-239, § 7811(i)(4)(B), substituted “any distribution of” for “any disposition of”.

1988—Subsec. (a)(4). Pub. L. 100-647, § 1012(p)(10)(A), added par. (4). Former par. (4) redesignated (5).

² So in original. Probably should be “provisions”.

Subsec. (a)(5). Pub. L. 100-647, §1012(p)(10), redesignated par. (4) as (5) and substituted “paragraph (2), (3), or (4)” for “paragraph (2) or (3)”.

Subsec. (b)(1). Pub. L. 100-647, §1012(p)(36), substituted “investment company which” for “investment corporation which”.

Subsec. (b)(3)(A). Pub. L. 100-647, §1012(p)(22), amended subpar. (A) generally. Prior to amendment, subpar. (A) read as follows: “such corporation (and any predecessor) was not a passive foreign investment corporation for any prior taxable year.”

Subsec. (b)(5). Pub. L. 100-647, §1012(p)(17), substituted “part where held” for “section where stock held” in heading, and amended text generally. Prior to amendment, text read as follows: “Under regulations, in any case in which a United States person is treated as holding stock in a passive foreign investment company by reason of subsection (a), any disposition by the United States person or the person holding such stock which results in the United States person being treated as no longer holding such stock, shall be treated as a disposition by the United States person with respect to stock in the passive foreign investment company.”

Subsec. (b)(6). Pub. L. 100-647, §1012(p)(20), substituted “Except as provided in regulations, if a” for “If a”.

Subsec. (b)(8). Pub. L. 100-647, §1012(p)(24), added par. (8).

Subsecs. (c), (d). Pub. L. 100-647, §1012(p)(35), added subsec. (c) and redesignated former subsec. (c) as (d).

EFFECTIVE DATE OF 2007 AMENDMENT

Amendment by section 11(f)(2) of Pub. L. 110-172 effective as if included in the provision of the American Jobs Creation Act of 2004, Pub. L. 108-357, to which such amendment relates, see section 11(f)(4) of Pub. L. 110-172, set out as a note under section 904 of this title.

EFFECTIVE DATE OF 1998 AMENDMENT

Amendment by Pub. L. 105-206 effective, except as otherwise provided, as if included in the provisions of the Taxpayer Relief Act of 1997, Pub. L. 105-34, to which such amendment relates, see section 6024 of Pub. L. 105-206, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 applicable to taxable years of United States persons beginning after Dec. 31, 1997, and to taxable years of foreign corporations ending with or within such taxable years of United States persons, see section 1124 of Pub. L. 105-34, set out as a note under section 532 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by section 1501(b)(10), (11) of Pub. L. 104-188 applicable to taxable years of foreign corporations beginning after Dec. 31, 1996, and to taxable years of United States shareholders within which or with which such taxable years of foreign corporations end, see section 1501(d) of Pub. L. 104-188, set out as a note under section 904 of this title.

Amendment by section 1703(i)(5), (6) of Pub. L. 104-188 effective as if included in the provision of the Revenue Reconciliation Act of 1993, Pub. L. 103-66, §§13001-13444, to which such amendment relates, see section 1703(o) of Pub. L. 104-188, set out as a note under section 39 of this title.

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by Pub. L. 103-66 applicable to taxable years of foreign corporations beginning after Sept. 30, 1993, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end, see section 13231(e) of Pub. L. 103-66, set out as a note under section 951 of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101-239 effective, except as otherwise provided, as if included in the provision of

the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100-647, to which such amendment relates, see section 7817 of Pub. L. 101-239, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section applicable to taxable years of foreign corporations beginning after Dec. 31, 1986, see section 1235(h) of Pub. L. 99-514, set out as a note under section 1291 of this title.

Subchapter Q—Readjustment of Tax Between Years and Special Limitations

Part

- I. Income averaging.
- II. Mitigation of effect of limitations and other provisions.
- [III, IV. Repealed.]
- V. Claim of right.
- [VI. Repealed.]
- VII. Recoveries of foreign expropriation losses.

AMENDMENTS

1997—Pub. L. 105-34, title IX, §933(b), Aug. 5, 1997, 111 Stat. 882, added item for part I.

1986—Pub. L. 99-514, title I, §141(c), Oct. 22, 1986, 100 Stat. 2117, struck out item for part I “Income averaging”.

1981—Pub. L. 97-34, title I, §101(c)(2)(C), Aug. 13, 1981, 95 Stat. 183, struck out item for part VI “Maximum rate on personal service income”.

1976—Pub. L. 94-455, title XIX, §§1901(b)(36)(E), (37)(F), 1951(c)(3)(D), Oct. 4, 1976, 90 Stat. 1802, 1803, 1841, struck out items for parts III and IV “Involuntary liquidation and replacement of LIFO inventories” and “War loss recoveries”, respectively, and substituted in item for part VI “Maximum rate on personal service income” for “Other limitations”.

1966—Pub. L. 89-384, §1(g)(1), Apr. 8, 1966, 80 Stat. 104, added item for part VII.

1964—Pub. L. 88-272, title II, §232(f)(3), Feb. 26, 1964, 78 Stat. 112, substituted “averaging” for “attributable to several taxable years” in item for part I.

PART I—INCOME AVERAGING

Sec.

- 1301. Averaging of farm income.

PRIOR PROVISIONS

A prior part I consisted of sections 1301 to 1305, prior to repeal by Pub. L. 99-514, title I, §141(a), Oct. 22, 1986, 100 Stat. 2117.

§ 1301. Averaging of farm income

(a) In general

At the election of an individual engaged in a farming business or fishing business, the tax imposed by section 1 for such taxable year shall be equal to the sum of—

(1) a tax computed under such section on taxable income reduced by elected farm income, plus

(2) the increase in tax imposed by section 1 which would result if taxable income for each of the 3 prior taxable years were increased by an amount equal to one-third of the elected farm income.

Any adjustment under this section for any taxable year shall be taken into account in applying this section for any subsequent taxable year.